Patient capital in the pensions landscape is what most have been waiting for, so after the Chancellor's recent Budget announcement that the government will look to open up DC pension pots into illiquid investing, what will this look like? And will it stand the test of time? Theo Andrew investigates

Summary

- The Chancellor announced in this year's Budget that it would be consulting on measures to open up DC investments into patient capital.
- The industry has long been calling for the opportunity to open up DC investment into illiquid assets, but worry the Chancellor's initiative would become a 'half measure'.
- A number of key barriers remain, namely permitted links and fund types, but industry and government backing is strong.
- The government has said it will consult on the charge cap as part of the programme, a move which concerns many.

The pensions industry is used to waiting around a long time for incremental change, so when Chancellor Philip Hammond announced he was looking to open up patient capital investment for defined contribution pension pots, it was an apt development.

Hammond's declaration in this year's Autumn Budget that he was set to pave the way to use billions of pounds of defined contribution pension money to fund fast-growing British technology companies was welcomed by many, before the finer details began splitting opinion.

The patient capital initiative, which will sit alongside the government's £2.5 billion patient capital programme, will look to funnel pension investments into fast-growing British technology companies, opening the door for DC pension schemes in invest in illiquid assets.

So while it seems like it has been a long time coming, the speed at which the government and industry is looking to move on change suggests itchy feet. The irony is not lost on many.

The Financial Conduct Authority (FCA) will have published its consultation by the end of the year, while the government will have two consultations, around permitted links and fund types, also out before Christmas. The more contentious consultation on the charge cap will be out in the first half of 2019.

Elsewhere, several of the largest pensions schemes, including Nest, Aviva, HSBC, L&G, The People's Pension and Tesco's Pensions Fund are working with the British Business Bank to explore options for pooled investments into patient capital.

With big-name backers, which suggest the initiative is here for the long-haul, and with DC assets under management expected to total £1 trillion by 2025, it is well worth waiting around for.

So, with seemingly a lot of energy

already being focused on bringing this to fruition, what barriers are still left standing in the way?

Breaking down the barriers

One of the main, but much less discussed barriers, is that of permitted links, which according to JLT head of investment consulting Maria Nazarova-Doyle, has been widely misunderstood.

She says that permitted links, which restrict the type of investments that insurers can offer DC schemes to ensure they remain "reasonably liquid", does in fact allow for some illiquid investments, such as direct property and land, but has called for clarity on the issue.

She says: "We need it clarified, everybody needs to understand clearly how it works, and if it isn't a problem to have illiquid in DC then let's just call it out, getting the government and the FCA to say 'its not an issue', because I think the misunderstanding is quite wide across the industry."

Furthermore, there was concern around the scope of the initiative, which has been branded "narrow".

"The way it reads, although we will have to wait for the consultation document, is that the government is only looking at patient capital itself ... which then becomes a half measure," Nazarova-Doyle says.

"You wouldn't want to have one particular asset type in one country, which is the UK; it's very narrow in terms of the asset allocation. What you would want is a diversified set of alternative investments for the long term."

Despite this, speaking at the Pensions and Lifetime Savings Association Annual Conference in October, Pensions Minister Guy Opperman asked the industry to put more money into infrastructure projects, as the government worked "hand in glove" with the Treasury to make it easier to invest in unlisted infrastructure.

It would seem as if this was the start of the process that would enable DC schemes to invest into the wider illiquid landscape, rather than just into the high-growth firms Hammond outlined in his speech.

Trade Union Congress policy officer, Tim Sharp, says: "We think it's a good thing to invest in our economy; what we don't want to see is government attempting to direct where pension scheme money should go."

"Ultimately, it should be up to trustees to decide where the money is going to be directed. We think there is a role for government in encouraging larger scale; one of the most exciting opportunities in pensions at the moment is the large master trusts."

PTL managing director, Richard Butcher, agrees: "The challenge for a group of trustees is that you are committed to a long-term, illiquid investment, which doesn't give you a licence to get involved with the corporate governance of that illiquid investment … That creates a number of governance demands that are not common among our other investments."

Despite these barriers, one of the more contentious issues, which is imperative for the government to get right, is the charge cap.

Uncapping the charge

A measure being considered in the midst of opening up investment opportunities is increasing the charge cap, currently set at 0.75 per cent, in order to offset performance fees.

Sharp says: "We don't want other nasties slipped under the radar at the same time, around loopholes with the charge cap to offset performance fees, which we think will be a grave mistake."

However, the issue is more about how pension schemes verify that they are compliant with the cap, rather than the issue of performance fees.

Pensions Age understands that the government will not be weakening the cap by excluding performance fees, on the basis that not all performance fees are fair. When members don't make a choice about whether to save, or where to save, they have a right to a cap on the charges they pay.

Despite this, Sharp believes creating any sort of loophole would be a slippery slope and would "halt the progress that has been made for greater transparency".

"You have to be particularly careful, we are approaching April and we are about to ask members to put more money into their pensions and in order to retain the trust of savers, they have to see their money working as hard as possible and to suggest a loophole here for the asset management industry seems counterproductive," he says.

Furthermore, Nazarova-Doyle argues that, by keeping the charge cap in its current guise, funds will still rush to market over fear of missing out on a "slice of that pie".

There is even the argument that the very concept of the charge cap is a "wholly inappropriate tool", with the real issue being governance.

Butcher says: "It's treating the symptom of disease, not the disease itself. The symptom is overcharging and expensive products, the actual disease is poor governance and if you fixed it across the board then any level of charges would be appropriate. Rather than change the charge cap, I would much rather remove poor governance and let that dictate the charge."

There is no doubt that the opening up of DC schemes to illiquid investments will be widely welcomed by the industry. The direction could end up testing the resolve of all those who have been waiting so patiently.

Written by Theo Andrew