A push for the long term

The government recently confirmed its finalised framework for the Long-term Asset Fund, although industry concerns persist around the charges and potential delays for members. Sophie Smith reports

After much anticipation, the Financial Conduct Authority (FCA) recently finalised the rules for its Long-term Asset Fund (LTAF) framework, in an effort to encourage greater investment in long-term illiquid assets.

The LTAF will be a new FCA-regulated fund designed specifically to help investment in assets including venture capital, private equity, private debt, real estate and infrastructure. It is expected to address the "market failure" seen as DC pension schemes failed to invest in long-term illiquid assets, despite having the investment horizon to do so.

It aims to secure an appropriate degree of protection for consumers, with protections build into the structure that are commensurate with the degree of risk from investing in a fund that is predominantly exposed to illiquid assets. The FCA acknowledged that these protections cannot remove all investment risk, clarifying however, that it secures an "appropriate level" of consumer protection for investors to whom an LTAF can be marketed or offered as part of a DC pension scheme default strategy.

"The LTAF means that scheme members now have better opportunities to benefit from potential illiquidity premiums of long-term illiquid assets," it stated. "By requiring the LTAF's redemption terms to match the liquidity of the underlying investments, we consider this will help advance our market integrity objective."

The FCA also confirmed that it will push ahead with amendments to permitted link rules, including removing the 35 per cent limit for LTAF-linked funds that form part of a pension scheme default arrangement. These amendments are expected to allow more flexibility in the use of illiquid assets via the LTAF, to enable more flexibility in the construction of DC scheme portfolios while maintaining an adequate level of protection for DC default investors.

Commenting at the time of the framework's launch, FCA chief executive, Nikhil Rathi, said: "We are supporting fresh collaborative thinking designed to improve the effectiveness of UK markets while protecting standards. If this innovative fund structure, created by our rules, is taken up by the asset management industry, it may provide alternative routes to returns for investors, while supporting economic growth and the transition to a low carbon economy."

Industry experts have also welcomed the FCA's finalised rules, yet concerns remain as to the charges involved and potential delays for members.

Hymans Robertson head of DC investment, Callum Stewart, noted that the proposal to remove the upper limit on exposure to investments for LTAFs will particularly help address one of the current constraints limiting innovation.

"As always, however," he clarified, "we should consider member needs first. This development should support greater product innovation and choice for DC schemes, and ultimately improve outcomes for members."

Aegon pensions director, Steven Cameron, also warned that an overnight 'big bang' rush is unlikely, as DC members expect to be able to switch funds, transfer between schemes or access their pensions flexibly, all without any delay or notice period.

"LTAFs will have notice periods of various lengths and the underlying assets won't have daily prices with redemptions no more frequently than monthly," he said, continuing: "One consideration will be the length of notice periods set by LTAFs with the FCA prescribing a

minimum of 90 days but with some likely to be far longer if targeting certain types of illiquid investment. Arrangements for arriving at a daily price between LTAF valuation points to feed into the default fund price will all be critical.

"Schemes will also need to explore how to manage liquidity within the default fund, when the proportion in the LTAF is not readily realisable."

Adding to this, AJ Bell head of investment analysis, Laith Khalaf, suggested that there could be cost concerns, warning that any additional long-term returns will need to be weighed up against the charges for investing in LTAFs, particularly given the charge cap on pension default funds.

"Private equity investment for example, is not exactly known for its bargain basement fees, and pension schemes will have to assess the benefit of investing in illiquid assets against any additional costs to members," he explained. "Many pension schemes have already shifted heavily towards passive funds to keep charges down, and may be reluctant to see their annual management charge creeping back up."

Written by Sophie Smith