Productive finance working group publishes recommendations addressing the barriers to investment in less liquid assets

The Productive Finance Working Group is industry led, co-chaired by the Governor of the Bank, the Chief Executive of the FCA, and the Economic Secretary to HM Treasury.

Appropriately managed, investment in such assets has the potential to generate better returns for investors, including those saving for retirement in defined contribution (DC) pension schemes, given their typically long-term investment horizons. These types of pension schemes are an increasingly important vehicle for saving for retirement, given their assets have increased from around £200 billion in 2012 to over £500 billion today, and are expected to double to £1 trillion by 2030.

Investment in productive finance assets can also benefit the wider economy by supporting the economic recovery from Covid, facilitating the transition to a net zero economy and supporting financial stability. Greater investment in longer-term productive UK assets, such as research and development, technology, and infrastructure can provide a boost to long-term growth and support an innovative, greener future for the UK.

However there are a number of barriers and challenges to investment in less liquid assets and therefore these investment need to be carefully managed. The aim of the Group, convened in November 2020, was to propose solutions to such barriers, including a roadmap, timetable and set of actions.

In its report published today, ‘A Roadmap for Increasing Productive Finance Investment’, the Group has published four recommendations, underpinned by 13 specific actions, with a focus on supporting DC pension schemes to invest and developing the long-term asset fund (LTAF) structure.

The recommendations require action from industry and the official sector and will create an environment in which DC schemes and other investors can benefit from appropriate long-term opportunities. They include:

- Shifting the focus to long-term value: DC schemes trustees, trade bodies and consultants should consider how increasing investment in less liquid assets could generate greater long-term value for their members.

- Building scale: The DC market has a high proportion of small schemes. Their lack of scale can make it challenging for them to invest in less liquid assets for a variety of reasons.

- A new approach to liquidity management: Most DC schemes currently invest predominantly in daily-dealing funds which in theory means their holdings can be sold at short notice. Investment in less liquid assets does not present the same daily dealing opportunity. Therefore a broader range of DC schemes should find ways to enable them to invest in less liquid assets as part of a diversified portfolio. To support that, the Group recommends industry develop guidance, in collaboration with the Bank and FCA, on good practices for liquidity management at a fund level.

- Widening investment in less liquid assets: The group recommended that the FCA consult on changing its rules for investment in illiquid assets through unit-linked funds and reviewing the LTAF distribution rules to facilitate wider distribution to appropriate retail clients.

Chancellor of the Exchequer, Rishi Sunak, said:

> Now is the time for institutional investors to seize the moment and invest in longer-term UK assets. By doing so they can help boost Britain’s long term growth, enable pensions savers to access better returns, and support an innovative, greener future for the UK.
>
> So it’s great that the industry working group have put forward proposals that will help to overcome the barriers to investing in long-term UK assets and I look forward to seeing them put into action.

Andrew Bailey, Governor of the Bank of England, said:

> Addressing the investment barriers which exist for long-term assets can help unlock valuable economic opportunities. Carefully managed, this is especially important for people saving in their retirement and the broader economy. The input that the working group has provided over the past year in coming up with these recommendations should be commended and it is vital that they are implemented.

Nikhil Rathi, Chief Executive of the Financial Conduct Authority, said:

> Defined contribution pension schemes have increased in importance over the past 10 years with increasing numbers of people using them to save for their retirement. Supporting access to different investment opportunities, which have the possibility to provide more diversified returns to members as well as benefiting the wider economy, is important. The working group produced a group of recommendations that could really make the difference and my colleagues and I at the FCA look forward to working with the

industry and others to ensure they are implemented.

Chris Cummings, Chief Executive of the Investment Association said:

> Investing in illiquid assets is a way for savers to diversify their portfolios and at the same time provide capital for long term projects which boost the economy. The Long-Term Asset Fund will offer DC pension schemes and certain retail investors a new way to access illiquid investments through a fund structure designed specifically for such investments.
>
> We welcome this report, in particular the work done by the Productive Finance Working Group to identify barriers to distributors offering funds with limited redemption opportunities and the commitment to look closely at allowing the LTAF to be sold to a broader range of retail investors with appropriate safeguards. We look forward to working with policy makers, investment managers, distributors and other organisations to take forward the report’s recommendations to make the LTAF a success and increase the supply of productive finance in the UK economy.

Michael Moore, Director General of the BVCA, said:

> The Productive Finance Working Group is a hugely significant initiative. Not only is it encouraging collaboration and the sharing of perspectives from across the financial services sector, it’s also tackling the challenges faced by certain types of investor that are currently excluded from the impressive returns of private equity and venture capital funds.
>
> The BVCA welcomes its involvement in the group and the opportunity it has had to provide data and guidance on investing in this sector. We are confident that the group’s recommendations can help defined contribution pension schemes and other investors along the path towards allocating to our asset class. We look forward to supporting the group’s ongoing workstreams.

Ruston Smith, Chair of the Tesco Pension Fund, said:

> Many members in defined contribution schemes typically have long term time horizons and, in delivering good member outcomes, good quality illiquid assets can contribute towards improved diversification and future net risk adjusted returns. Other countries’ DC schemes and UK DB schemes have, for some time, included appropriate allocations to private markets as part of their aim of delivering good member outcomes.

Following the success of automatic enrolment, this initiative is incredibly important to further improve the incentive and accessibility of good quality illiquid assets for UK defined contribution schemes and their members. Further support from consultants and on trustee education, in this important area, will help provide good informed decisions and the further development of UK DC investment strategies.

John J. Haley, CEO, Willis Towers Watson

Willis Towers Watson views the report produced by the Productive Finance Working Group as a critical step forward in getting more illiquid, productive investments into Defined Contribution schemes, thereby improving the investment outcomes for millions of Defined Contribution members in the UK; We are proud to have been an active participant in the project.

We recognise there remains work to be done in this area, and we look forward to continuing our work with other committed stakeholders to further improve the UK DC market.

Chris Hill, Chief Executive Officer, Hargreaves Lansdown, said:

Over the last 18 months many have reassessed their finances and started to consider their plans for later life, with many investing for the first time to build their financial resilience. We are all responsible for our own retirements, so Hargreaves Lansdown particularly welcomes the recognition of the rights of retail investors and their importance to the UK economy in the report.

When people have enough savings for emergencies and the time to invest for the long term, they should have the option to access these types of opportunities as part of their investment portfolio. Providing the right information to ensure investor knowledge and understanding of the risks of these new funds will be essential for their safe distribution.

Further information:

1. The final report, ‘A Roadmap for Increasing Productive Finance Investment’ has been published.
2. Further details on the Productive Finance Working Group, including Minutes from their meetings can be found online.
3. FCA CP21/12: A new authorised fund regime for investing in long term assets can be found online.