FYI® Alert
For Your Information®

Volume 2022

Issue 10

12 April 2022

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The DWP's latest proposals on investing in illiquid assets

Over recent years the government has sought to encourage trustees to consider illiquid assets in their investment allocation.

There have been a number of consultations setting out various plans from different parts of government. The DWP is currently consulting on proposals aimed at increasing the visibility of trustee investment in illiquid assets through disclosure in the statement of investment principles for the default arrangements of DC schemes, and for larger DC schemes, the chair's statement.

Background

The DWP's latest consultation is made up of four parts. There are responses to a previous consultation on excluding certain illiquid assets from the regulatory charge cap for DC default funds and a call for evidence on the potential need for greater consolidation of DC schemes – neither of which are going to be proceeded with at the current time.

The DWP is now consulting on draft regulations to make the legislation on employer-related investments (which dates back to the 1990s and focused on DB schemes) more relevant to large master trusts with at least 500 employers.

Of more relevance to most DC schemes (and DC sections of hybrid schemes) are the proposals that seek to improve the disclosure of trustee investment in illiquid assets.

What are illiquid assets?

The DWP recognises that there is a lack of clarity over a legislative definition of illiquid assets. The consultation suggests two options for defining them – either at a scheme level, or at a more granular asset level.

1. Schemes use a range of different vehicles to invest in illiquid assets. Some of these vehicles are in effect liquid i.e. they (or shares in them) can be traded frequently and sold with ease despite

investing in illiquid assets. Given that almost all DC scheme investment is done indirectly, it could be specified that illiquid funds or illiquid vehicles are the more appropriate subsection of investment options to hold a policy on. Funds could be deemed as illiquid once they reach a certain percentage threshold of their allocation being illiquid.

2. If the investment itself is not able to be sold frequently, perhaps daily, this could be counted as an illiquid asset no matter the investment vehicle through which this is disclosed. This could be done by listing asset classes that are considered illiquid. This would require a scheme to 'look-through', for example, a multi-asset fund to understand the allocation within a particular fund.

Illiquid asset policy – the statement of investment principles

The DWP is proposing that trustees of DC occupational pension schemes (or the DC sections of hybrid schemes) will need to explain their policy towards illiquid investments in their statement of investment principles (SIP) in relation to the default arrangement.

The SIP should describe the average percentage holding and type of illiquid assets in the default fund and the benefits the trustees feel these assets bring to their scheme and members. This explanation should be concise – the DWP suggests between one and three paragraphs. It is proposing that trustees cover issues such as:

- what illiquid assets are and whether trustees choose to invest in them;
- which members will be holding illiquid assets (does the scheme lifestyle members in and out of illiquid assets and at roughly what age?);
- what factors they consider when deciding whether to invest in these assets;
- any current barriers to investment in illiquid assets and any future plans for investment in them.

Conversely, where trustees choose not to include illiquid assets in their default arrangements, the DWP wants members to be able to understand why.

Disclosure of illiquid asset policies in the SIP would be provided in line with current SIP disclosure requirements. Effectively, this means reviewing the SIP at least every three years and without delay after any significant change in investment policy.

The DWP's proposals to do not apply to DB schemes or self-select funds within DC schemes/sections.

Asset allocation disclosure – the chair's statement

The DWP is proposing that DC schemes (with over £100 million of assets under management and which are required to produce a chair's statement) disclose the percentage of assets allocated in the default arrangement to each of the following seven main asset classes: cash, bonds, listed equities, private equity (including venture capital and growth equity), property, infrastructure, and private debt.

The DWP intends to issue guidance to describe how trustees should disclose this information.

The determination of total assets would be taken from the latest version of the audited accounts, in the same way as the scope of the value for members' assessments was determined. Trustees of a hybrid scheme would determine whether they are in scope based on consideration of total assets (both DC and DB) and whether this figure is above or below £100 million.

The DWP believes that members should have access to this information, and while most pension providers already offer it in some form, disclosure is not uniform. This makes it difficult for members to compare across different schemes. It is broadly agreed that members should be better engaged with their pension, how their money is invested and be aware of pertinent information about their pensions to be able to compare between offerings.

The DWP is proposing that these disclosures are incorporated into the timeframe for confirming net returns (i.e. annually in the chair's statement). In order to reflect the changes in the asset allocation that trustees may make during the course of a scheme year, the DWP believes that trustees must use an average allocation, by selecting four valuation points throughout the year, no closer than three months apart, at which the percentage allocation to each asset class is calculated. A mean average of these percentages should then be calculated and disclosed.

What's next?

The consultation runs until 11 May 2022, although there is no indication at this stage of when the DWP's disclosure proposals are likely to come into force.

Buck comment

The DWP makes it clear that is not seeking to impede trustees' fiduciary duty by insisting schemes invest in any specific asset class or sector. Instead it is looking to encourage further diversification and investment in assets that bring higher returns.

Trustees looking to invest in illiquid assets need to ensure they are acting in members' best interests, rather than simply assisting the government's drive to tap into the purchasing power of pension schemes to drive further illiquid asset investment.

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