LIFTS Secretariat

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By Email Only to
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Dear LIFTS Secretariat

LCP's response to the request for feedback on the Long-term Investment for Technology and Science (LIFTS) initiative

Lane Clark and Peacock LLP

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have around 1,000 people in the UK, including 160 partners and over 300 qualified actuaries.

We have a specialist DC practice and advise nearly 150 DC schemes, with assets in excess of £30bn in total, which provide for over 1 million UK DC savers. Schemes range from under £10m in assets to those with just over £6bn. This includes both single sponsor arrangements and master trusts.

The provision of actuarial, investment, covenant, governance, pensions administration, benefits advice, and directly related services, is our core business. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy. The remaining 20% relates to insurance consulting, energy, health and business analytics. LCP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Introduction

As an introduction to our response, it should be noted that LCP provides investment consulting services to trustees of UK pension schemes and other types of organisations, the vast majority of which do not have regulatory permissions to set-up to assess large numbers of venture and growth company investments. Further, LCP does not provide investment management services such as fiduciary or fund management as we offer a fully independent consulting service. As such, our clients will largely be relying on third-party managers to identify and assess any individual investment opportunities, structure any funds through which these investments will be made and to execute any deals.

We welcome the government's initiative to provide incentives for investment in the UK. A strong UK economy, supported by growing companies in science and technology is in the interests of UK DC schemes' members. We note recent comments by ministers about the lack of investment by UK pension schemes in UK growth assets, and UK equities in particular. We welcome proposals to both facilitate investment and provide financial incentives for DC pension schemes to invest in the UK. Scheme trustees will take these factors into consideration when judging where to invest capital for the benefit of their members, and help promote the UK from the wide range of possible investment opportunities.

Our overarching view is that UK DC schemes are very well placed to consider investment into less liquid assets. A number of our clients have or are considering making investments into these types of assets with the long-term view that these types of allocations can help improve member outcomes. Our experience so far, however, is that schemes are tending to look for broader private market solutions rather than specific asset class exposure and hence, this further suggests the reliance on third-party managers to engage in this area, on behalf of their investors.

That said, our view is that investment in UK venture and growth equity in science and technology is a niche area for DC schemes (and indeed many DB Schemes). It is to an area that most DC schemes have really explored due to the complexity of investing in these assets, the costs associated with investing and the lack of any appropriate solution or fund for the DC market. As such, we are pleased to see the challenge set for the industry and have welcomed the opportunity to input to this important request for feedback ahead of the LIFTS Call for Proposals due to be published in May.

We are happy to be quoted in any government response.

1. In your view, will the options for delivery be effective in achieving the LIFTS objectives? Please outline any adjustments to these options that you believe would increase their effectiveness.

As we have noted, investing in UK venture and growth equity in science and technology companies is not a common consideration for DC scheme trustees. While DC schemes have, in theory, a broad universe of possible investments, the core areas have been listed and liquid assets due, mostly, to practical difficulties in accessing other more illiquid assets. While DC investment strategy is evolving and schemes are broadening their search for asset classes that offer the potential to help improve member outcomes, we see a number of challenges that need to be recognised in meeting the LIFTS objectives and in the selection of any proposals:

- **Access:** Our view is that the vast majority ofschemes, in the main, are unlikely to invest directly into a single asset class such as that proposed through LIFTS. There are a number of reasons for this, the largest being that, in the context of a wide range of possible investments, smaller asset classes tend to be grouped together and accessed through a fund or mandate that has scope to invest more broadly. Other reasons include the complexity around investing, timing risk, fairness to member issues and offering scale. As such, schemes are more likely to be looking to the manager community to consider allocating through a broader private market or asset solution. We believe it is important that managers should be able to structure any LIFTS solution as part of another, broader, investment product – accepting that, any government support is linked specifically to the LIFTS solution. This could affect the approach for Qualifying investments.

- **Scale:** It is important that any solution created for the DC market has the potential to amass the required scale and hence, we believe all four Options can help open the door to DC investment. There have been examples where industry solutions launched previously have not had the required support and hence, failed to reach scale and their original target. As such, we do not believe any bespoke or scheme specific proposal should be allowed as part of the LIFTS Call for Proposals.

- **Fiduciary duty:** Given the ultimate fiduciary duty placed on trustees, trustees and their managers will need to consider the investment merits of venture and growth equity in science and technology companies rather than other return seeking assets and then any proposed allocation to UK rather than overseas. As such, while these are not barriers to UK DC investment, to improve the level of interest and size of potential allocations, our view is that incentives from LIFTS should be focused on supporting the investment case. Options three and four do offer some support to the investment case as such, we believe these Options should be given priority.

- **Platforms:** Given the vast majority of schemes use institutional platforms to access their investments, these platforms remain a key obstacle to investment as they may not agree to add any LIFTS solution, or even a broader private market solution which contains a LIFTS solution, to enable DC scheme investment. This was highlighted by the Productive Finance Working Group (PFWG) in their call to action for platforms (see page 74 of https://www.lcp.uk.com/pensions-benefits/publications/key-considerations-when-investing-in-less-liquid-assets/). We believe early engagement with platform providers would support broader take-up and interest. Further, our view is that any successful proposal must be expected to meet standard institutional platform requirements to enable access by the vast majority of DC schemes, either directly or via a broader investment product – our view is the Long-Term Asset Fund (LTAF) is likely to be most appropriate. This should be a requirement for the LIFTS Call for Proposals.

- **Member fairness:** We have worked with a lot of managers to consider how they are structuring their private market solutions for DC schemes and members. In particular, investing in this asset class creates significant hurdles to ensure members benefit fairly from the investment. There are J-curve issues, infrequent pricing and valuation, cashflow management (both deposits and withdrawals) and potentially performance related fees. Any solution will need to resolve these to an extent that schemes are comfortable to invest. We believe all interested parties should be asked how they intend to resolve these issues as part of their proposal.

- **Performance fees:** While we are in discussion with some clients on performance related fees, we are yet to see any interest, with schemes instead opting for ad-valorum charges, often due to member fairness concerns. This could affect take-up and interest of any successful proposal.

- **Timeline:** While the proposed timeline notes a successful proposal will be announced in November 2023, our view is that any ultimate investment into a LIFTS solution is unlikely to be possible until very late 2024 or even 2025 given the potential that a new fund or funds will need to be created and then onboarded to a platform. As such, while this initiative may indeed have potential to unlock UK institutional investment, it may take time to come to fruition.

2. Which option, or combination of options, would your organisation be most interested in if you were to put forward or support a proposal in due course?

While we will not be putting forward our own proposal, we would consider supporting another organisations proposal.

While all Options have the ability to open the door for more UK DC investment, our view is that Options three and four are most attractive because they have the added ability to affect the investment case by either improving potential upside returns for members (Option three), or reducing management fees (Option four).

That said, Option 4 requires inclusion of a performance fee element, a concept which remains very new to DC schemes design. We have yet to see any manager confirm the inclusion of a performance fee for DC scheme investment and little interest from schemes. Performance fees can cause problems with fairness allocating fees across different underlying members. The option 4 solution increases the proportion of total fee paid as a performance fee and reduces the flat fee for the fund, possibly exacerbating the problem of fee- fairness. Any solution would need to consider this carefully and we suggest, utilise the guidance published by the PFWG on performance fees in less liquid funds.

3. **Do you agree that a requirement to invest at least 50% of the proposed fund or structure into qualifying investments would be a suitable minimum threshold for proposals? If not, what alternative threshold would you propose that would achieve sufficient focus on UK science and technology companies?**

As we've noted, we expect DC schemes are more likely to invest in UK venture and growth equity through a fund or mandate that has a remit to invest in a much broader set of assets, and not through a specialist fund. We, therefore, think the 50% may constrain investment and mean that few funds that DC schemes use would see any benefit. We suggest that solutions are structured so that any fund or structure investing in qualifying investments can benefit from the solutions, with the benefit suitably scaled by their level of investment in qualifying investments.

4. **Do you agree with the proposed definition of qualifying investments? If not, what alternative definition would you propose that would achieve sufficient focus on UK science and technology companies?**

We do not have any comments to make on this question.

5. **How likely is your organisation to put forward a proposal in due course, either individually or in collaboration with others? If relevant, please summarise any changes that would make your participation more likely.**

As noted above, LCP will not be submitting a proposal directly, however, we anticipate working with investment managers on their proposals.

Yours faithfully

SENT BY EMAIL 28 APRIL 2023

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