Laura Trott, MBE, MP
Minister for Pensions
Department for Work and Pensions

By email: CaxtonHouse.pensiontrustees@dwp.gov.uk

5 September 2023

Dear Minister

Re: Pension trustee skills, capability, and culture: a call for evidence

The BVCA is the industry body and public policy advocate for the private equity and venture capital (private capital) industry in the UK. With a membership of around 650 firms, we represent the vast majority of all UK-based private capital firms, as well as their professional advisers and a large base of UK and global investors. We are happy for the content of this submission to be quoted in any future Government response.

Why the BVCA agrees with the direction of Government policy in this area

We welcome the Government's agenda of improving opportunities for UK pension scheme investment in productive finance, including private capital funds, and improving UK pension savers' retirement outcomes. The direction of Government policy here is supported by robust BVCA returns data which clearly demonstrate that the UK's private capital fund industry has a four-decade track record of delivering market-beating returns and diversification benefits for global institutional investors. Investment activity data provided by BVCA members also clearly demonstrates that UK pension schemes comprise only a very small part of the UK private capital fund industry's pension investor base, which is dominated by overseas pension schemes (alongside other types of institutional investor), so UK pension savers have been missing out.

We therefore applaud the Department for Work and Pensions' (DWP) objectives of encouraging consolidation amongst UK's pension schemes, where necessary, and facilitating their access to long-term, high-performing illiquid assets. The Mansion House proposals are an opportunity for the Government to improve retirement prospects for millions of UK pension savers by starting to level the playing field between UK schemes and other institutional investors. Non-UK pension schemes, for example, already improve the outcomes they achieve for their beneficiaries by building balanced, resilient portfolios with a broad range of assets, including illiquid strategies. Currently members of overseas pension schemes are benefitting from investment in UK growth companies via UK private capital funds, which offer different risk-return profiles and collectively have consistently outperformed public equities.

In addition, the UK private capital fund industry is a critical partner for Government in driving economic growth and ensuring that the UK's high-growth businesses of tomorrow can access the capital they need to start up and scale up in the UK. In 2022, £27.5bn was invested by private capital funds into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. There are over 12,000 UK companies backed by private capital, which currently employ over 2.2 million people in the UK. Over 55% of the businesses backed are outside London and 90% of the businesses receiving investment are small and medium-sized businesses. The UK pensions industry urgently needs improved access to these innovative, unlisted UK companies that private capital funds identify and then support to realise their growth potential. The private capital fund industry's investment of capital and expertise in that collective potential is a powerful driver for broader economic growth across the UK.

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We have responded below to the questions in the call for evidence on which our members have specific views.

Q2. Do trustees currently meet the knowledge and understanding requirements expected of them? Are some types of trustees better than others?

The standards for knowledge and understanding expected of individual trustees are set out in section 247 of the Pensions Act 2004 and require them to have knowledge and understanding of the law relating to pensions and trusts, the principles relating to the funding of occupational schemes and the investment of scheme assets. Clause (5) provides that the "degree of knowledge and understanding required [...] is that appropriate for the purposes of enabling the individual properly to exercise [their] functions as trustee of any relevant scheme." The Pensions Regulator (TPR) guidance on 'Understanding your role' for trustees says that they must "understand the investment options you offer members and make sure they are offering appropriate fund choices."

Appropriate fund choices:

We agree with the Government's assessment that UK pension schemes are underinvested in alternative asset classes, including private capital, and that greater UK pension scheme investment is appropriate and would benefit UK pension savers and the wider UK economy.

The benefits of investing in UK private capital funds are already acknowledged by pension schemes around the world. The successes of Canadian and US schemes investing in alternative asset classes is well known. Yet, despite the UK having the second largest pensions market in the world, UK pension schemes invest much less in private capital funds than their global peers. Data from the BVCA's Report on Investment Activity shows that while 30% of all capital raised by our members' UK private capital funds in 2022 came from pension schemes, often based in North America, only 4% came from UK pension schemes.

Independent commercial data from Preqin confirms that the Canadian pension schemes most active in private capital investments allocate on average 21% of their capital to private equity and the top US schemes average 14%. By contrast, even the most active UK DB schemes in private capital allocate just 5%.

We feel the evidence is very clear that allocations to private capital funds can be appropriate for pension schemes (as long-term investors) and that UK pension savers have been missing out on the market-beating returns and the benefits of diversification that UK private capital funds have provided to non-UK pension scheme investors.

Understanding the investment options:

As identified by the Productive Finance Working Group, a Bank of England, FCA, and HM Treasury sponsored industry forum, one of the key barriers to UK pension schemes (DC in particular) investing meaningfully in private capital is a lack of the skills and networks needed to confidently invest in the asset class.

It is our view that UK pension scheme trustees could benefit from further support to better understand the UK private capital industry, to help develop the understanding and networks needed to execute a program of private capital fund investments. After decades of investing mainly in listed, liquid and fixed income assets, many UK pension scheme trustees often have limited experience and are wary of the fees associated with higher risk/higher reward illiquid, alternative investments, like private capital funds. We welcomed the DWP and TPR's joint statement on investment in illiquid investments (included in the Productive Finance Working Group's Roadmap for Productive Finance Investment) that calls on trustees that do not have the skills or expertise to consider opportunities in private markets to address this and consider what advice and other support is needed. Increased awareness of private capital could help trustees gain confidence when considering private capital investment strategies. As trustees often rely on investment advisors and consultants, specialists in these groups may be well placed to facilitate such training and awareness in the first instance.

The Government can also play a key role in helping the UK pension scheme trustees to better understand their alternative investment options by bringing together pension schemes with those who already invest in private capital, supporting trustee learning and helping UK pension schemes to develop in-house expertise in alternative asset classes. We understand that several UK pension schemes are already looking to develop their understanding and hire specialist teams, but without continued Government support, further progress may be slow and fragmented.

As we have seen in the run up to and following Mansion House 2023, the Government can help facilitate discussion and engagement on investment in UK private capital. Bringing together the private capital industry and pension scheme trustees in this way will help to expedite and standardise the development of skills and expertise across the industry. This will enable UK pension schemes to start making appropriate allocations to UK private capital more quickly, to the benefit of UK pension savers and the wider UK economy.

Q4. Do trustees (including Master Trust trustees) have the right knowledge and understanding to invest in the full breadth of investment opportunities? If not, what can be done to improve this?

See section on 'Understanding the investment options' in our response to Q2, above. Please also see our response to the Department for Business and Trade's Request for Feedback on the Long-term Investment for Technology and Science (LIFTS) initiative in which we comment on the need for the Government to support DC pension schemes to upskill CIOs to understand the venture capital and growth capital markets.

On a related note, from the 1 October this year, trustees or managers of occupational pension schemes will need to disclose and explain their policies on illiquid investment as well as their full asset allocations of investments from their default arrangements. We welcome these DWP regulations requiring the publication of asset allocation data as an important step towards transparency, and we think it will help to raise awareness amongst trustees and scheme members of the full breadth of investment opportunities available to them. It will help to identify gaps, compare allocations between schemes and encourage learning and greater diversification.

Q8. Do current accreditation frameworks provide a high enough bar to equip trustees who become accredited to properly fulfil their role, including in making investment decisions?

As discussed in our responses to Q2 and Q4, there appears to be a skills and expertise gap for UK pension scheme trustees in investing effectively in alternative asset classes, including private capital funds. This may restrict the investment decisions made by trustees, with consequences on investment performance and diversification. We suggest more awareness is needed to unlock illiquid asset classes and that relevant accreditation frameworks could help to address gaps and improve trustees' collective investment decision making. The BVCA, as the industry association for the UK's private capital industry, would be pleased to support discussion and considerations of these issues going forward.

Q14. What changes could be made, including to the regulatory environment, to improve trustee support in relation to unlisted equities?

As set out in our response to Q4, the DWP's incoming requirements for trustees to disclose and explain their policies on illiquid investment as well as their full asset allocations of investments from their default arrangements should help trustees and their advisors to identify gaps in knowledge, experience, and allocations. This will help them to start thinking more seriously about investing in unlisted equities.

There is a role for the Government and the regulators to continue encouraging trustees to consider the opportunities that unlisted equities can provide for better risk adjusted returns and greater diversification, rather than focussing on keeping scheme costs low (see our response to Q20.).

Q19. Do trustees currently make investment decisions in the long-term interests of pension savers? If not, what barriers are there to trustees making investment decisions in the long-term interests of savers?

We welcome the DWP's recent legislative changes and proposals to facilitate UK pension scheme investment in long-term, high-performing illiquid assets, like private capital funds.

As set out in our responses to Q2, Q4, and Q5 above, better trustee awareness is needed to help to address the skills and expertise gap currently preventing some trustees from making investment decisions that could improve long-term outcomes for savers. We also recommend that further consolidation of UK pension schemes into fewer, larger schemes will help to facilitate UK pension scheme access to investment opportunities in the long-term interests of savers. Scale allows schemes to achieve an appropriate level of geographic, sector and asset class diversification, which should support stronger returns and diversification benefits.

Q20. How do trustees balance investment returns, costs and charges, and services when making decisions in the long-term interests of savers?

The Productive Finance Working Group's roadmap included a recommendation on the need to shift the focus to long-term value for DC pension scheme members. The working group found that to date, the DC pension industry has sought to ensure costs to investors are kept low, and that an "excessive focus on costs alone could result in investments, potentially providing better value for money, being overlooked – to the detriment of savers."

The costs of investing in private capital are higher than investing in public markets because the process of investing is more intensive and requires significant resources and expertise. However, private capital as an asset class can provide investors with higher returns, net of fees, and the benefits of investing in UK private capital funds are already acknowledged by pension schemes around the world. The successes of Canadian and US schemes investing in alternative asset classes is well-known.

Private capital funds have a four-decade track record of delivering stronger returns than the public markets and data in the BVCA's Report on Investment Activity shows that the average duration of a private capital fund's investment in a company is five years, as opposed to five and a half months for the average investment in a publicly listed company. Ensuring UK pension schemes can access these long-term investment opportunities could therefore lead to better outcomes for UK pensions savers as well as boosting economic growth.

On that basis, we believe there is a role for the Government and the regulators to work with industry to continue to encourage trustees to consider the opportunities in alternative asset classes, which can provide better risk adjusted returns and greater diversification, rather than focussing on keeping scheme costs low.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor (ttaylor@bvca.co.uk) and Nicholas Chipperfield (nchipperfield@bvca.co.uk).

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