



**Response by TISA to:
Consultation: Enabling investment in productive
finance**

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About TISA

The Investing and Saving Alliance (TISA) is a unique, rapidly growing membership organisation for UK financial services.

Our ambition is to improve the financial wellbeing of all UK consumers. We do this by focusing the convening the power of our broad industry membership base around the key issues to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA membership is representative of **all sectors of the financial services industry**. We have **over 200-member firms involved in the supply and distribution of savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

As consumers, the financial services industry and the economy react to and recover from the effects of the pandemic, the importance of the three key pillars of work that TISA prioritises has never been more apparent:

- **Strategic policy initiatives** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of **consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments**.
- TISA is recognised for the **expert technical support provided to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new rules and regulations covering **MiFID II, CASS, ESG/RSI, operational resilience, Cyber Risk, SM&CR** and a range of other areas.
- **Digital transformation initiatives** that are driving ground-breaking innovation and the development of industry infrastructure for greater operational effectiveness and revenue promoting opportunity for firms. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives – **TISAtech** (a digital marketplace that brings together financial institutions and FinTechs for greater collaboration and innovation) and **TURN** (TISA Universal Reporting Network – a digital platform providing a secure data exchange for financial services using blockchain technology) – alongside projects **Digital ID** and **Open Savings & Investment**. This reflects TISA's commitment to open standards and independent governance.

Executive Summary

TISA welcomes the opportunity to respond to the DWP consultation ‘Enabling investment in productive finance.’

We welcome efforts to improve outcomes for pension savers. As such, we support this proposal which would give DC schemes the ability to access many private and long-term investments, and in turn the returns these asset classes offer, provided the correct guidance and support is given. At present, trustees are prevented from accessing investments that charge performance fees, meaning they are not able to make the allocation even if they felt like it would be additive to their portfolio.

It is essential that the necessary support is given to Trustee and IGC boards to enable them to have the knowledge to be able to make these determinations. Detailed scenario planning, illustrating the charges over and above the basic examples in the CP would be of great benefit, as not all boards may have the scale, resource and access to the necessary expertise needed.

We also support a principles-based approach to guidance on performance fees, which empowers governance boards to take decisions based on their investment strategies and objectives. In line with this, we suggest guidance on the structure, calculation, and application of performance fees is based on standards already in existence, which allow flexibility in how fees are calculated, while ensuring good governance.

As scheme members are not a homogenous group and the various scheme propositions which exist reflect this, there is no one solution that could achieve the objective for all groups involved within the value chain. What we do see are different initiatives emerging which will suit different groups – this provides the flexibility that is needed for schemes and employers to enable access to these assets, if deemed appropriate. These initiatives include the Long-Term Asser Fund regime and DC consolidation. Given that scheme members all need similar support, protection, and opportunities in their retirement journeys, we should be looking to align all investment initiatives across the Trust Based and Contract Based regulatory regimes.

We do need to be cognisant that cost still currently remains a major factor for many decision makers when determining an appropriate AE investment strategy for their workforce. A potential increase in costs, irrespective of the trade-off that could be achieved through more stable and higher longer term net returns may not immediately incentivise this group. However, the continued drive for better VfM within the AE framework, should help educate this group as to the potential benefits that could be achieved through the inclusion of illiquid assets within their default investment strategies.

The removal of investment barriers to DC schemes are a welcome opportunity if complexity can be kept to a minimum, the necessary guidance is in place and above all, good consumer outcomes are the primary objective.

Question responses

Question 1a: Would adding performance-based fees to the list of charges which are outside the scope of the charge cap increase your capacity and appetite, as a DC scheme, to invest in assets like private equity and venture capital? Are you already investing in assets like private equity and venture capital, and if so, would this change increase how much you invest? If you do not currently invest in such assets would this change make it more likely for you to, and do you have an idea of to what % of AUM that might be?

There are several pension scheme types currently used by employers to meet their Auto Enrolment (AE) obligations, including Group Personal Pensions, Master Trusts and Single Employer Trusts. Scheme investment decisions will therefore be made using different considerations applicable to their proposition, their membership base and target market.

We welcome efforts to improve outcomes for pension savers. As such, we support this proposal which would give DC schemes the ability to access many private and long-term investments, and in turn the returns these asset classes offer, provided the correct guidance and support is given. At present, trustees are prevented from accessing investments that charge performance fees, meaning they are not able to make the allocation even if they felt like it would be additive to their portfolio. While investment management for these asset classes tends to have higher overall costs, performance fees are only charged when a pre-agreed level of performance is achieved, and in general returns are higher.

More generally, IGC and Trustee assessments are moving towards a more holistic approach embracing Value for Money (VfM) and cost is just one aspect to consider. There are other initiatives currently in progress to incentivise illiquid investment such as DC consolidation and the Long-Term Asset Fund (LTAF) regime, which we see as complementary to this proposal.

We do need to be cognisant however, that cost still currently remains a major factor for many decision makers when determining an appropriate AE investment strategy for their workforce. A potential increase in costs, irrespective of the trade-off that could be achieved through more stable and higher longer term net returns may not immediately incentivise this group. However, the continued drive for better VfM within the AE framework, should help educate this group as to the potential benefits that could be achieved through the inclusion of illiquid assets within their default investment strategies.

Given that employees are not a homogenous group and the various scheme propositions which exist reflect this, there is no one solution that could achieve the objective for all groups involved within the value chain. What we do see are different initiatives emerging which will suit different groups – this provides the flexibility that is needed for schemes and employers to enable access to these assets, if deemed appropriate. Given that scheme members all need similar support, protection, and opportunities in their retirement journeys, we should be looking to align all investment initiatives and opportunities across the Trust Based and Contract Based regulatory regimes.

Question 1b: Would adding performance-based fees from the list of charges which are outside of the scope of the charge cap incentivise private equity and venture capital managers to change their fee structures?

This would depend on the demand created by DC schemes to invest in these assets should the proposals be implemented. Schemes would need to conduct individual discussions with fund managers to discuss the potential scale of investment and negotiate an appropriate fee structure for their existing membership and target market.

Question 1c: If you do not believe that the proposal outlined in this consultation is the right solution to the barrier posed by the regulatory charge cap, what might be a more effective solution?

Over and above the existing initiatives already in place (DC consolidation and LTAF regime), any additional opportunities should span across the Trust Based and Contract Based regulatory regimes and have a clear and primary objective of enhancing member outcomes.

Question 2: How can we ensure members of occupational DC pension schemes invested in default funds are sufficiently protected from high charges, whilst adding the performance related element of performance fees to the list of charges outside the scope of the charge cap?

There is already strong governance in place for both Trust Based and Contract Based schemes, with a further focus on VfM recently introduced for the annual assessments. The framework in place should protect scheme members from being defaulted into investments which do not offer good value. It is, however, essential that the necessary support is given to Trustee and IGC boards to enable them to have the knowledge to be able to make these determinations. Detailed scenario planning, illustrating the charges over and above the basic examples in the CP would be of great benefit, as not all boards may have the scale, resource and access to the necessary expertise needed.

It is generally considered that should the proposals be implemented, competitive pressures should help restrict the escalation of charges, over and above what would be considered appropriate.

The timing of the fee deductions needs to be considered, to ensure the mechanism is fair to all scheme members, taking into account fair apportionment to scheme joiners and leavers. Timing and fair treatment of members is something we think should be addressed in guidance for trustees and has been covered in existing standards (see answer to Q3).

Question 2a: Do you have any suggestions for how we can ensure that the regulations ensure members are only required to pay fees when genuine realised outperformance is achieved?

We believe this is being considered from an incorrect perspective. Hurdle rates are set on the basis of absolute returns rather than relative to a benchmark. Fee structures are agreed between the client and fund manager based on needs and expected returns. It would be unhelpful to hard-wire any specific and pre-determined structures into the charge cap rules.

Question 3: Which of these conditions should the government apply to the types of performance-based fees that are excluded from the list of charges subject to the charge cap? Are there other conditions we should consider? If supported by guidance on acceptable structures would this give confidence to more schemes?

Whilst we understand there is a need to protect scheme members, there is an Auto Enrolment governance framework already in place designed to provide this.

We support a principles-based approach to guidance on performance fees, which empowers governance boards to take decisions based on their investment strategies and objectives. In line with this, we suggest guidance on the structure, calculation, and application of performance fees is based on standards already in existence, which allow flexibility in how fees are calculated, while ensuring good governance:

- There are FCA principle-based guidelines on the use of performance fees, covering the choice and application of benchmarks or hurdles, and guidance on accrual periods and disclosures.
- Guidelines issued by the European Securities and Markets Authority (ESMA) covering performance fee calculation, consistency with investment objectives, frequency of crystallisation, negative fees and loss recovery, and disclosures. From April 2020, investment funds sold-cross border into the UK from the EU are already subject to these.,
- Finally, in 2016 the International Organisation of Securities Commissions (IOSCO) issued Good Practice for Fees and Expensive of Collective Investment Schemes, with detailed but principles-based examples of good practice for how fees, including performance fees, should be applied.

It is worth noting that none of these standards seek to define specific or typical hurdle rates or base fee / performance fee ratios.

Question 4: Do you agree with our proposal to require disclosure of performance fees if they are outside the scope of the charge cap? If so, we propose this is done in a similar way to transaction costs – do you agree? Could you provide details of any new financial costs that could arise from a requirement to disclose performance fees? Please outline any one-off and ongoing costs.

Yes, we fully agree that we need to maintain consistency and transparency with cost disclosures. As there should be a positive correlation between costs and investment performance, it is important that they are both illustrated in a way where this link can be easily identified. If they are illustrated without the relevant context, the risk of misinterpretation is greatly increased, with a potential detrimental impact to consumer outcomes.

Question 5a: If we add performance fees to the list of charges which are not subject to the charge cap, do you agree that we should remove the performance fee smoothing mechanism and the pro-rating easement from the Charges and Governance Regulations 2015?

Yes, in the interests of retaining an element of simplicity, we agree that the removal of the smoothing mechanism should be removed.

Question 5b: Is there a need for transitional protection arrangements to be brought in for schemes that have decided to make use of the performance fee smoothing mechanism, and if so, what do these transitional arrangements look like?

We do not believe there is a need to implement any form of transitional protection, which is likely to add to the existing complication and create further barriers to understanding for all involved.

We are not aware of anyone implementing the smoothing mechanism to date. However, there is a small risk should this not be reflective of the whole market that for those schemes impacted, the charge cap may have already been breached before the 5-year smoothing time period is withdrawn. We believe that should this scenario occur, it is best dealt with on an exception basis.