Minutes of the first Steering Committee meeting
Tuesday 26 January 2021
Virtual meeting

Agenda

1. Reminder of competition law obligations by Simmons & Simmons LLP
2. Overview of the Working Group's purpose and ultimate objectives
3. Agreeing the barriers to productive investment the Working Group should focus on
4. Agreeing the deliverables from the Technical Expert Group ahead of the next Steering Committee meeting on 4 May

Item 1. Reminder of competition law obligations by Simmons & Simmons LLP

1. Simmons & Simmons LLP set out the legal obligations of all members of the Working Group relating to competition law. They reminded members that it is their responsibility to meet their legal obligations and to take their own legal advice.

Item 2. Overview of the Working Group's purpose and ultimate objectives

2. The co-chairs[1] set out the economic benefits of greater investment in productive finance. It would help to improve the UK's long-term productivity growth. It would also aid the UK's coronavirus (COVID-19) economic recovery, by providing important long-term and stable sources of capital for companies, while also assisting the transition to a more sustainable and net zero carbon economy. Removing barriers to investment in productive finance will also provide investors a broader range of investments that will better align with their investment horizons (for example, for Defined Contribution (DC) pension schemes) and potentially offer higher returns over the longer term.

3. The Financial Conduct Authority (FCA) set out that, although closed-ended funds facilitate investment in productive finance assets, investor feedback suggests that these vehicles do not work for all investment mandates and there is a need for an option for investment in long-term assets via open-ended authorised fund structures. The Working Group could help facilitate such structures. The Working Group should draw on a large amount of existing work on the barriers to investment in productive finance. Its focus should be to identify practical ways to address both the operational and demand side barriers, and set out a clear roadmap for their implementation. This would support the Chancellor's public commitment to set up a Long-Term Asset Fund (LTAF) later this year.[2]

4. The Working Group is expected to run for six months, with the Steering Committee meeting three times. A successful outcome for the Working Group would be to have facilitated:
   - the launch of at least one LTAF, with capital having been committed from a broad range of investors;
   - supporting the establishment of the regulatory framework for an LTAF, so that its structure meets the needs of a broad range of investors;
   - the creation of the necessary operational infrastructure, including intermediaries' distribution channels (including investment platforms) being able to support and offer non-daily dealing funds.

5. The FCA noted that it is open to re-examining its regulatory framework, including its distribution rules. The FCA are considering the need for a new authorised open-ended fund structure that will balance the flexibility needed for funds to invest in less liquid assets with appropriate

[1] John Glen, Economic Secretary to HM Treasury, Andrew Bailey, Governor of the Bank of England and Nikhil Rathi, FCA CEO.
[2] Chancellor statement to the House – Financial Services, on 9 November 2020.

consumer protections. All rule changes would be subject to the FCA's ordinary consultation process.

6. The Economic Secretary to HM Treasury noted that the Steering Committee meeting coincided with HM Treasury's call for input on the Review of the UK Funds Regime.[3] While tax proposals are outside the Working Group's Terms of Reference, members can use the separate HM Treasury Review to provide input on issues relating to both taxation and regulation of the UK funds regime.

7. The Economic Secretary reminded members that the Working Group's Terms of Reference had been circulated prior to the meeting for comment by written procedure.

Item 3. Agreeing the barriers to productive investment the Working Group should focus on

8. The FCA introduced six of the most significant barriers to productive investment identified by existing work:

   i. Reluctance among investors to invest in non-daily dealing / non-daily priced funds.
   ii. Reluctance among investors to invest in less liquid assets, in both open and closed ended funds, due to various concerns, including the risk and cost associated with these types of assets.
   iii. Lack of suitable existing authorised fund structures to offer exposure to productive finance assets.
   iv. Capability of many investment platforms (both life and retail) to support non-daily dealing funds.
   v. Unit-linked structures not enabling investors (including DC pension schemes) to obtain meaningful exposure to funds investing in productive finance assets.
   vi. Legislative barriers, for example requirements for DC pension schemes to liquidate holdings within 6 months in certain circumstances.

9. It was observed that the demand barriers (i-ii above) relate largely to DC pension schemes, despite the sound economic argument for their investment in less liquid long-term assets. Among the operational and legislative barriers (iii-vi above), there is a coordination failure preventing platforms offering non-daily dealing funds: platforms could upgrade their systems to offer non-daily dealing funds, if investor demand commercially incentivised them to do so, while product manufacturers would only offer non-daily dealt funds if they could be distributed on platforms.

10. The Minister for Pensions and Financial Inclusion noted that the lack of scale in the DC market is one of the most important barriers to productive investment. This prevents greater allocation to private assets, such as infrastructure. The Government's response to the Department for Work and Pensions' (DWP) consultation on pension fund consolidation is expected in the Spring.[4] This

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[3] Review of the UK funds regime: a call for input.

[4] Improving outcomes for members of defined contribution pension schemes, Department for Work and Pension consultation, September 2020.

builds on DWP's October 2020 consultation, which proposed that funds with less than £100m in assets consolidate with other funds, or explain why not. The Working Group's discussion will be relevant to the Government's response to the consultation. Several members, and the Governor of the Bank of England, agreed with the need for greater consolidation in the sector. The Minister for Pensions and Financial Inclusion also noted the importance of considering the role of green gilts in supporting productive investment.

11. There was broad agreement from members about the significance of the six barriers to productive investment outlined above.

12. On barriers to demand, several members felt a shift in investment culture was required. Investing in less liquid assets is not sufficiently part of the 'fiduciary narrative' for pension trustees and other asset managers with long-term investment horizons. The Governor of the Bank of England, noted that the expectation for funds to be daily dealing, even when they hold less liquid assets, contributes to the under-pricing of liquidity in the financial system.

13. DC pension schemes were also perceived to be too focused on costs, rather than overall future expected returns, and member outcomes, net of costs. Less liquid assets are typically more expensive to manage, especially compared to the index-tracking investments predominantly used by DC pension schemes. But investment in less liquid assets may also offer higher returns. By focusing more on costs rather than net returns, pension schemes may under-invest in less liquid assets. The challenge is that the likely additional cost of investing in such assets would need to be met by the member (that is, a higher overall member charge) or would result in a lower margin for the provider or Master Trust.

14. On the operational barriers, the Steering Committee discussed the suitability of existing authorised fund structures in offering exposure to productive finance assets (iii above). Some members believed existing fund structures, such as investment trusts, were sufficient and that the main barriers lay on the demand side. Others highlighted that existing fund structures designed to invest in long-term assets (for example, the European Long-term Investment Funds and the Qualified Investor Scheme) do not effectively balance the need to invest in long-term assets with providing access or appropriate protections for retail investors.

15. The Minister for Pensions and Financial Inclusion agreed that the capability of many investment platforms to support non-daily dealing funds (iv above) should be a key focus for the Working Group. The Minister noted that the solutions proposed by the Group also need to focus on how to stimulate demand and sell these opportunities to investors.

16. Several members highlighted that unit-linked structures do not enable investors to obtain meaningful exposure to funds investing in productive finance (v above). Permitted links rules should be reviewed in tandem with any new fund structure. Another member noted that insurers may also face regulatory barriers from Solvency II, including the matching adjustment and capital requirements on investment in equity.

17. One member agreed that requirements for DC pension schemes to liquidate holdings within six months, in certain circumstances, can be a constraint on holding less liquid assets (vi above). The

Minister for Pensions and Financial Inclusion agreed that the Technical Expert Group, which sits under the Steering Committee, should explore whether this warranted a review.

18. In addition to the barriers set out in the background Working Group papers, some members thought that the Group should examine barriers to investment faced by Defined Benefit (DB) pension schemes. These include barriers for pension schemes seeking buyouts by insurers to invest in certain productive finance assets.

19. The discussion also touched on tax. While tax proposals are outside of the Working Group's remit, one member noted that it was an important factor in investment decisions and that the ongoing HM Treasury review would benefit the Group's discussion.

Item 4. Agreeing the deliverables from the Technical Expert Group (TEG) ahead of the next Steering Committee meeting on 4 May

20. The Steering Committee discussed the intended target market for the LTAF. This will be an important question for the TEG to explore ahead of future Steering Committee meetings. Some members, whilst recognising that the LTAF was unlikely to be a product for the mass retail market, nonetheless, wanted an LTAF to be available to sophisticated segments of the retail market, as well as institutional investors. Others commented that, as this was a new product which would be investing in asset classes not traditionally available to retail investors in an open-ended structure, and which might require notice periods exceeding a year, it would not be suitable for most retail investors. Careful consideration, along with input from the advisory community, would be required about how it conforms to tax wrappers (for example, ISA's, SIPP's). One member noted that listings on exchanges can help provide access to retail investors.

21. Given the challenges of distributing a new product to the retail market, some members thought the initial focus should be on delivering an LTAF for institutional investors (most notably large DC pension schemes), before facilitating access to retail investors at a later stage.

22. To ensure a non-daily dealing LTAF is available on platforms, one member recommended initially focusing on platforms used by the DC default schemes in Master Trusts. It is more complicated to adapt platforms for separate elective funds in a DC scheme. Private investor platforms (for example, ones that enable investment in an ISA or a SIPP) also present additional operational challenges.

23. While much of the discussion focused on operationalising an LTAF, several members suggested the Working Group also explore adapting existing vehicles, such as investment trusts, rather than developing a new open-ended fund structure. It was noted that if a new open-ended fund is developed, careful consideration will need to be given to the rules to ensure that it can hold less liquid assets (for example, with long notice periods), while offering appropriate levels of consumer protection. This would be subject to the FCA's ordinary policy-making process, including public consultation.

24. Several members asked whether the LTAF is intended for investment in 'greenfield' productive finance assets, or for existing assets. These two types of assets are likely to have different risk

and return profiles. Unless there is an increase in the stock of productive finance assets, more pension fund investment into the existing stock of less liquid assets may simply lead to asset price inflation.

25. There was general agreement that the Working Group should propose solutions that would encourage greater investor focus on net returns (rather than cost) and longer investment horizons The Group might consider potential metrics to help pension trustees to do this, as well as improvements to the transparency of costs around investing in less liquid assets. The Minister for Pensions and Financial Inclusion suggested that the Working Group might want to consider changes to the guidance on trustees' fiduciary duties that would support greater investment in less liquid assets.

26. In his summary of the discussion between the members, the CEO of the FCA suggested that the TEG should consider three broad classes of solutions: recommendations of potential changes to rules and regulations (for example, around disclosure and permitted links); improvements to operational infrastructure (for example, platform dealing frequency); and shifting the 'fiduciary narrative' (for example, shifting the focus from cost to net returns and to longer horizons).

The Productive Finance Working Group

Attendance:

Co-chairs

Andrew Bailey	Bank of England
John Glen MP	Her Majesty's Treasury
Nikhil Rathi	Financial Conduct Authority

Private sector attendees

Paolo Alonzi	Aberdeen Standard Investments
Jack Inglis	Alternative Investment Management Association (AIMA)
Huw Evans	Association of British Insurers (ABI)
Ian Sayers	Association of Investment Companies (AIC)
John Smitherman-Cairns	Aviva
Rachel Lord	Blackrock
Hani Kablawi	BNY Mellon
Gurpreet Manku	British Private Equity and Venture Capital Association (BVCA)
Anne Richards	Fidelity
Chris Hill	Hargreaves Lansdown
Ian Stuart	HSBC
Ian Simm	Impax Asset Management
Chris Cummings	Investment Association (IA)
Jeff Davies	Legal & General
Denzil Jenkins	London Stock Exchange Group
Martin Stanley	Macquarie Asset Management
Mark Fawcett	Nest
Sarah Brewer	Partners Group
Richard Butcher	Pensions & Lifetime Savings Association (PLSA)
Addy Loudiadis	Rothesay Life
David Williams	Simmons & Simmons LLP
Miles Celic	TheCityUK (TCUK)
Bill Galvin	Universities Superannuation Scheme
John Haley	Willis Towers Watson
Ruston Smith	Chair of the Tesco Pension Fund
Paul Trickett	Chair of trustees for the Santander and National Grid Pension Schemes

Official sector attendance

Guy Opperman MP	Department for Work and Pensions
Tom Bramhill	Secretariat (Financial Conduct Authority)
James Howat	Secretariat (Bank of England)
Alan Mankikar	Secretariat (Bank of England)
Alex Brazier	Bank of England
Lee Foulger	Bank of England
Imane Bakkar	Bank of England
Sophie Stone	Bank of England
Emma Moriarty	Bank of England
Leo Fernandes	Bank of England
Sadie Lambie	Her Majesty's Treasury
Fraser MacLeod	Her Majesty's Treasury

The Productive Finance Working Group

Rachel Mumford	Her Majesty's Treasury
James Screen	Her Majesty's Treasury
Josh Fleming	Her Majesty's Treasury
Katie Fisher	Her Majesty's Treasury
Edwin Schooling Latter	Financial Conduct Authority
Nike Trost	Financial Conduct Authority
Mhairi Jackson	Financial Conduct Authority
Michael Collins	Financial Conduct Authority
Pete Searle	Department for Work and Pensions
Andrew Blair	Department for Work and Pensions
David Fairs	The Pensions Regulator