DC PENSIONS AND SOCIAL INVESTMENT

Camilla Parke, Strategy and Market Development Associate

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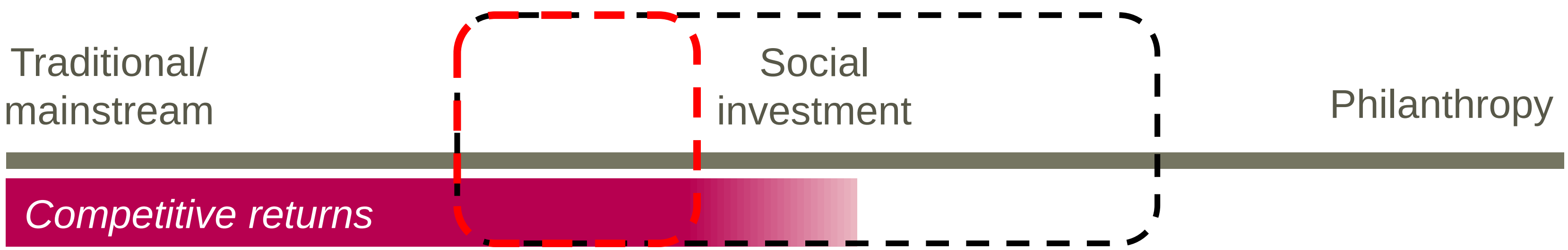
About Big Society Capital

Commmonweal Housing

We are here to grow the social investment market in the UK, as a market champion and as a wholesale investor

We have invested c. £340m to date in the UK, over £600m signed with match

What is social investment?



Why should DC pensions make social investments?

- Growing evidence that individual savers are interested in a social pension – being able to save for retirement and help address issues of concern to them.
- Opportunity to match long term investment profile of pension funds, with need for long term capital to support positive social outcomes
- But this is currently not happening – individuals are not able to make this choice

Circa £350bn assets in DC funds by 2030

Currently 16m DC pension holders.

34% say they are interested in a social pension option ~ could be 5 million savers.

What social investment assets are available for pension fund investment?

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- Estimate approximately **£67.4bn** of social investment assets suitable for pension fund investment targeting market rate or close to market rate of return and delivering social impact

'Established' investments achieving market rate returns		
Asset type	**Market size**	**Typical targeted (net) rate of return**
Housing Association bonds and secured loans for social housing	£59bn	Typically 1.5-2.5% higher than inflation linked gilts, zero-default record
Charity Bonds	£6.5bn (£6.4bn are large listed)	Listed retail CB typical 4 – 4.5% coupon. Unlisted varies.
Emerging investments targeting market rate returns, still building track record		
Equity like-lending, charities & SEs	£32m	Targeting close to market rate
Green bonds	£1.6bn	Average yield 1.5 – 2% (5.5 year bond with AA rating)
Higher risk investments targeting close to market rate return		
Social Impact Bonds	£14m	Target range 5 – 15%.
Social property e.g., affordable housing	£130m	Levered funds 10-12%, Unlevered 5 – 7%
SME charity debt, unsecured loans	£158m	Secured 3 – 6% Unsecured 8 – 10%

Sources: The size and composition of social investment in the UK, Big Society Capital, available here: https://www.bigsocietycapital.com/sites/default/files/attachments/The%20size%20of%20and%20composition%20of%20social%20investment%20in%20the%20the%20UK_3.pdf

KEY AREAS FOR CONSIDERATION

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Addressing liquidity

What's the problem?

FCA Permitted Links
Further, regulation around permitted is highly restrictive, which can make it challenging for DC funds to diversify. Given there is no legal requirement for DC funds to only invest in liquid assets, more could be done to enable funds to be structured to incorporate illiquid assets.

Members' statutory right to transfer
Applies at any time for DC funds. The requirement for members to be able to quickly transfer funds is a significant perceived barrier

Note: Implications for investment into infrastructure, social infrastructure and social investments. Illiquid assets can be invested into indirectly though this adds structural complexity

Solution

Clarity around the application of FCA regulation on "permitted links" in the context of DC pension funds – expand the list of permitted links

Amend statutory regulation to include the provision for individual to 'opt in' to accept lower liquidity on a portion of their fund to achieve social aims

Consider ways to encourage the provision of liquidity through third parties for potentially small portions of funds invested in illiquid assets

Addressing fiduciary duty

What's the problem?

Default fund, trust and contract based: Fiduciary duty

In practice, challenging for trustees (or IGCs, employers and providers with fiduciary-like duties) to take into account non-financial factors even if there is clear evidence of member interest, if there is any degree at all of possible risk of financial detriment.

This could prevent trustees from choosing a default option where a small proportion of the fund was invested into social investments, even if these targeted market rate returns.

Note: Fiduciary duty is less of a barriers for chosen funds

Solution

Changes in legislation to give trustees and ICGs comfort that social infrastructure and social investments are in accordance with their legal duties, including the duty to act in the best financial interests of beneficiaries

Clarify through legislation or statutory guidance how Trustees may interpret the risk of 'significant financial detriment'.

Mandating a social pension option

What's the problem

Barriers outlined above are creating uncertainty and inertia

In practice, this means that Trustees are unlikely to take the step to offer a social pension option, even if there is evidence that savers are interested in this choice and assurance that such an option could be compatible with acting in members best financial interests

Solution

To address the current inertia we recommend that government mandate all DC pension schemes to offer a 'social' pension fund option

Scale through default fund but other challenges arise

Chosen fund more suitable?

Summary of recommendations

We recommend that government mandate all DC pension schemes to offer a 'social' pension fund option

Liquidity – Greater clarity is required to overcome structural barriers around investing in less liquid social investments. We recommend an amendment to members' statutory right to request transfers to provide an option to exclude a small, illiquid portion of a fund that could be channelled into social investments.

Fiduciary duty – Changes in legislation to give trustees comfort that social investments are in accordance with their legal duties, including the duty to act in the best financial interests of beneficiaries

Accreditation and labelling – There is a clear role for legal or regulatory backing for an independent body to accredit and label a social pension fund option.

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