

BIA consultation submission: Consideration of Illiquid Assets and the Development of Scale in DC schemes March 2019



Introduction

The BioIndustry Association (BIA) welcomes the opportunity to contribute to the DWP's considerations on facilitating pension funds' greater investment in illiquid capital, and particularly in small and medium sized enterprises (SMEs).

The BIA is the trade association for innovative life sciences in the UK. Our goal is to secure the UK's position as a global hub and as the best location for innovative research and commercialisation, enabling our world-leading research base to deliver healthcare solutions that can truly make a difference to people's lives.

Our members include:

- Start-ups, biotechnology and innovative life science companies
- Pharmaceutical and technological companies
- Universities, research centres, tech transfer offices, incubators and accelerators
- A wide range of life science service providers: investors; law firms; IP consultants; and investor relations agencies

We promote an ecosystem that enables innovative life science companies to start and grow successfully and sustainably.

Summary of the submission

- The UK has a thriving life sciences sector, which provides jobs and contributes to the economy, and delivers health and social benefits. The BIA supports DWP's aims to ensure funds held in pension schemes can be used to support innovative industries that bring these benefits whilst delivering real asset value growth for savers. **We want Britain's pension savers to be able to back British innovators**
- As noted by the Government's Patient Capital Review, the life sciences sector, and especially **the biotech SME sub-sector, lacks access to long-term patient capital and this is holding back the UK sector, and the contribution it can make to the UK economy and medical progress**
- The life sciences sector relies largely on specialist investors for finance, with pension funds and other generalist investors currently missing out on the opportunities it presents due to low levels of investment. **The public strongly supports medical research and wish to see real-terms growth in their savings but there are currently too few ways for pension savers to access these opportunities** presented by life sciences businesses
- The **BIA supports the Government's proposals to increase transparency** to aid customer choice by requiring pension schemes to publish their investment strategies in relation to illiquid assets and report on the implementation of those strategies. **Clear and plain English communications and a high degree of granularity – by both asset class and industrial sector – will be required to support better, more informed choices**
- Reporting requirements should also provide transparency of investments made through fund structures, which are an efficient and effective way for pension schemes to invest in illiquid assets

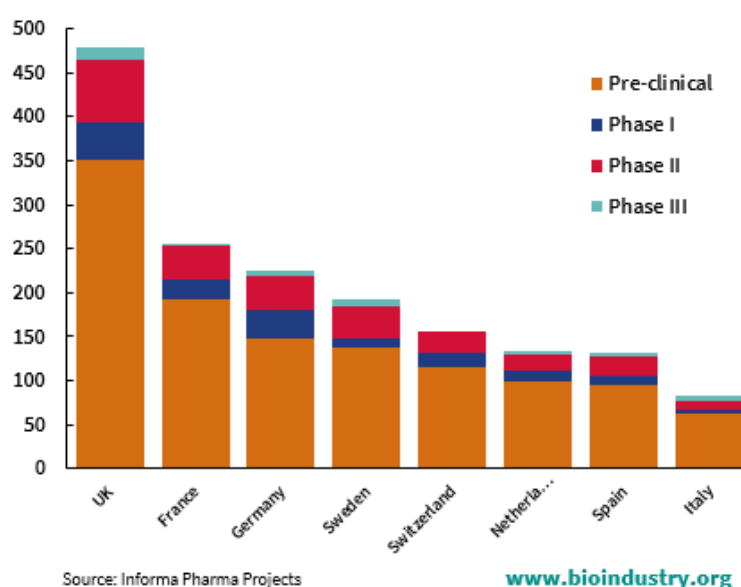
- Venture capital investment requires specialist knowledge and skills, plus more detailed due diligence, meaning it is more costly. **The BIA urges the Government to ensure that the charge cap and other requirements linked to fees do not restrict investment in the UK's innovative industries**
- We are concerned by the inclusion of research costs in the charge cap calculation, which will **exacerbate the potential risks of MiFID II reducing analyst coverage of the UK's innovative industries**, and believe that research should be considered a transaction cost instead

Overview of the UK's life sciences sector

The UK has a thriving life sciences sector developing medicines and other technologies that save and improve lives. The sector employs an estimated 64,120 people and generates £33.3bn in annual turnover (2015 figures)¹. It is supported by a service & supply sector that employs a further 54,900 people and generates £14.9bn in turnover.

Within the life sciences sector, there is a vibrant and innovative cohort of biotech SMEs, which are discovering and developing innovative new medicines and technologies at the cutting edge of scientific knowledge. Government figures² show that the UK biotech sector comprises almost 700 businesses, 71% of which are SMEs. These companies are developing innovative new medicines to improve the health of the population. The UK is also the European leader in life sciences, with more medicines in pre-clinical and clinical development than any other European country, with almost twice as many in development as our nearest competitor (France)³.

Generally, each SME will be focussed on a specific disease area, with only one or a small number of candidate drugs in development. The R&D of these medicines (and other biology-based innovations) typically takes ten years or more, is highly capital intensive and risky, due to the nature of scientific research. The companies are generally pre-revenue and must therefore finance themselves through successive rounds of venture capital fundraising without additional income (while public listings are



¹ [PwC \(2017\), commissioned by ABPI, BIA, BIVDA and ABHI, The economic contribution of the UK life sciences industry](#)

² [DHSC/BEIS/OLS: Strength and Opportunity 2017: The landscape of the medical technology and biopharmaceutical sectors in the UK \(May 2018\)](#)

³ [BIA/Informa \(2018\), Pipeline Progressing: The UK's Global Bioscience Cluster in 2017](#)

possible, they are difficult to conclude and are therefore increasingly not seen as a preferred finance source for small and emerging biotech companies). As the Government's Patient Capital Review rightly recognised, there is a current and particularly-acute gap in access to long-term and scale-up finance for life science companies in the UK.

The BIA therefore welcomes HM Government's and the DWP's contribution to the patient capital agenda. This submission is informed by our interactions with both member life sciences companies and the investment community, we are therefore able to provide an informed view of both sides of the investor-investee universe. Our response is limited to policy perspectives rather than specific legal rules, which others will be better placed to comment on.

Innovative sectors provide an opportunity to align savings and wider societal benefit

Medical research is the most popular charitable cause in the UK and at least eight million people donated to medical research charities in 2017⁴. Furthermore, 97% of the public think health research is important. There is clearly great interest within the UK population in supporting medical research.

As the consultation document notes, innovative sectors of the economy tend to be composed of more illiquid companies but also offer the greatest chance for large returns on investment. Pension savers should have the opportunity to invest in enterprises that will benefit their own and others' health *and* deliver real asset value growth for their savings to provide a comfortable income in retirement. As the Government department responsible for ensuring citizens can look forward to a comfortable retirement, ensuring they can access real growth opportunities that outperform inflation and the market should be a priority.

This will also help alleviate the access to capital challenges faced by many start-ups and scaling companies. As the Patient Capital Review consultation noted, in 1979 President Reagan provided assurance to pension managers that investing in early-stage companies was not imprudent. This led to a rapid increase in venture capital investments that fuelled the Californian tech revolution. Indeed, US pension funds are some of the largest investors in UK innovation, so it is US savers benefitting whilst UK savers miss out.

The BIA therefore supports policies presented in the consultations that aim to increase investment in innovative SMEs.

Reporting on the scheme investment approach

The rise of crowd-funding and ethical investment platforms exemplifies the growing interest among savers to take a more active role in their investments and savings. The BIA believes that the public have the right to make informed decisions and choose how and in what to invest. To facilitate this, it is necessary for pension funds to set out clearly their investment strategies, including their approach to investing in illiquid capital. Likewise, we support the Government's proposal for schemes to report annually via their Implementation Statement on their investments in venture capital. As the BIA stated in its response to the Patient Capital Review⁵, holding such asset classes may be currently viewed negatively by the pensions industry, so greater transparency could help change that perception as everyone would see others changing their behaviour and reaping the benefits, thus reinforcing the culture change. The Government should commission the Nudge Unit to provide some policy ideas to change pension trustees' behaviour here.

It will be important to use clear language and plain English to support greatest transparency. It will also be important to provide a high level of granularity in the classifications used. For example, it is common

⁴ <https://www.amrc.org.uk/pages/category/key-stats> (accessed 18 Feb 2019)

⁵ [BIA \(2017\), BIA submission to the HMT Patient Capital Review](#)

practice in the financial services industry to group venture capital into the broader private equity classification. This means that potential investors do not know if they will be supporting the buy-out of House of Fraser or a spin-out from the University of Manchester developing a cure for childhood leukaemia. Ideally a sectoral breakdown – life sciences, IT, hospitality etc. – would also be beneficial for investor choice, and is provided by some schemes already, suggesting it is not too onerous.

Regarding the definition of illiquid investments, we generally support that put forward in the consultation: “those which are traded off-exchange or are otherwise less readily tradeable”. However, pension funds may choose to invest through funds, which can be an effective way to pool assets to achieve scale and diversify risk through a portfolio of companies. These funds may themselves be listed and liquid so, to provide transparency for investors to know what their money is supporting, it will be necessary to reflect both the underlying investments in venture capital (and other economically and socially-useful assets) and that the investment is made through a less-risky liquid vehicle. However, a lower granularity of detail might be permissible in this instance, for example not specifying the industry sector.

Performance fees and the default fund charge cap

Venture capital investment is a specialist practice. Especially in technology-led sectors like the life sciences, it requires a deep understanding of the underlying technology and the business models in such industries, and involves taking calculated risks informed by extensive due-diligence. It is therefore not cheap and performance fees are often involved in funds that offer these services.

The BIA does not have a view on whether the current charge cap or how it is operated restricts investment in venture capital funds. But we strongly support action to address such restrictions where they exist. Indeed fees (irrespective of the statutory cap) are often cited by the pension fund industry as a reason why it cannot invest in venture capital. This is part of the risk-averse behaviour that is suppressing the returns that savers could achieve through a responsible and proportionate approach to investing in growth assets. We therefore urge the Government to take action to address this behaviour where possible, and this should be included as an objective of the planned review of permitted charging structures in 2020.

We are concerned at the inclusion of research costs in the charge cap calculation. Analysts research plays an important role in helping investors, especially generalists, to make investment decisions. It allows them to track trends in the sector as well as make specific stock picks. The introduction of the European regulation MiFID II at the beginning of 2018 has shifted the cost burden of research onto the fund manager. It is too early to make a conclusion on the impact of this but many believe that it will result in less research being written on specialist industries where there is already lower investor demand, including life sciences. As such, it becomes harder for companies to get exposure and attract investment. Including research costs in the cap will add an additional pressure on the demand for research, and exacerbate the risks of MiFID II to the UK's innovative, less liquid industries. It would be more appropriate to include it as a transaction cost as it directly informs that activity.

For more information on the content of this submission, please contact Dr Martin Turner, Head of Policy and Public Affairs, BIA, on 0207 630 2192 or mturner@bioindustry.org