Summary
- LTAFs were first announced in 2021, but it was in 2023 that the Mansion House reforms brought them into realisation.
- The aim of LTAFs was to improve access to investment in illiquid assets not usually readily available to pensions – thereby opening a funding stream for important areas like infrastructure.
- Since Schroders launched the first FCA-approved LTAF, the sector has expanded with over 30 now registered.
- New launches are emerging all the time, including those with a specific focus on areas such as the climate or innovation.
- In spite of concerns related to illiquidity, with the increase in scope of LTAFs and the reassurance of a sound regulatory framework, these vehicles look set to become a mainstay of scheme portfolios.

LTAFs: The new kids on the investment block

The beginnings of the Long-Term Asset Fund (LTAF) only go back to 2021, yet their popularity is undeniable. Sandra Haurant finds out what the future holds for this new vehicle

The beginnings of the Long-Term Asset Fund (LTAF) go back to 2021, when the Financial Conduct Authority (FCA) announced that this new category of open-ended fund would bring about efficient investment in long-term, illiquid assets, such as private equity, private debt, real estate and infrastructure. Today, there are dozens of LTAFs on the market. But while they began to take shape a few years before, it was the 2023 Mansion House reforms that saw the creation of the LTAF in its current form, says WTW's associate director, private markets, Toby Seely. "At that stage, LTAFs were particularly targeted at DC pension schemes – which had historically found it challenging to access certain asset classes – in order to boost UK pensions savings."

The first LTAF approved by the FCA was launched by Schroders in March 2023, and its primary focus was providing DC investors access to a wider range of the firm's private assets capabilities. On its launch, Schroders' head of UK institutional DC, Tim Horne, said: "Private assets have the potential to help DC investors achieve their aims of a good outcome in retirement. The LTAF regime has been specifically designed to provide a regulated fund structure that provides a framework to invest into these assets."

It's a new vehicle, but already a popular one, says WTW's Seely. "Initial uptake has been strong, with many large DC schemes increasing their allocation, while seeking greater diversification and inflation-linked returns," he says.

And the trend looks set to continue. "Recently, a number of large workplace pension providers have signed the Mansion House Accord, expressing an intent to invest up to 10 per cent of growth assets in private markets by 2030, with half of that allocated in the UK, demonstrating momentum in increased private markets allocations," he says.

So far, so good?

There are already many ways in which LTAFs have made access to private assets simpler for DC pensions, says Schroders' UK institutional client director, Ryan Taylor: "The ability to allocate across a range of asset classes including venture capital, private equity, infrastructure, real estate, private debt and natural capital, and provide an element of liquidity required by DC schemes, has made them the solution of choice for most pension schemes."

So, just what is it that works well for pensions? "There are a number of factors that have appealed to pension trustees when deciding to use an LTAF to access private assets," says Taylor.

"First and foremost, has been the range of investment options available for them to choose from."

Seely agrees, adding that this broadening of range brings with it the benefit of diversification and the potential for protection from inflation.

"Assets like infrastructure and real estate can offer long-term stable cash flows that hedge inflation risks. Private equity allows investors to benefit from larger parts of a company's growth journey than public markets," he says.

Then there is the perennial question of fees, which are, says Seely, "generally lower for LTAFs than creating a diversified portfolio of primary fund commitments". Using co-investment can drive fees down even further, he adds. What's more, access to LTAFs via trusted fund platforms is improving too, making it increasingly simpler for DC schemes.

Perhaps one of the more comforting aspects of LTAFs is that they come under stringent regulation. "LTAFs are regulated by the FCA, and hence fall under the same consumer protection awarded to more common pension fund structures," says Taylor.

Regulatory framework is reassuring for trustees, regulators and end savers, he says, comprising as it does of "an FCA-authorised structure with built-in governance, liquidity management and valuation processes".

It's not just DC schemes that have moved towards LTAFs, Taylor says: "The semi-liquid nature has also appealed to some corporate DB pension schemes with several years to end-game, and who still desire the characteristics of private assets, but in a more liquid structure than they have perhaps allocated to historically."

Built-in flexibility

Structural flexibility has become one of the prime benefits of the LTAF but, according to Seely, there are trends emerging in the shapes adopted by providers.

These include evergreen structures which, Seely says: "Allow for ongoing subscriptions and redemptions (subject to notice), which align well with DC schemes' need for daily pricing and periodic liquidity." The feeder fund model is also popular – here, managers create "feeder structures" which allow for investment through existing platform arrangements.

LTAFs may also be built as multi-asset or single-strategy vehicles.

"Both of these are available and serve different needs. Single asset-class vehicles focus on providing exposure to the distilled features of the given asset class focus e.g. private equity's focus on accessing unlisted investment opportunities, participating in the growth journey of a company through value creation and providing higher risk and return characteristics," Seely explains.

"Infrastructure might focus, on the other hand, on assets that provide yield-like cashflow dynamics, may have some form of asset backing or government funding and sit lower down the risk/return spectrum."

The liquidity question

While LTAFs can't offer daily liquidity, a quarterly liquidity structure offers redemption windows at given times (with notice periods), and these elements are becoming standard, Seely says.

Indeed, as Taylor points out, one of the great benefits of LTAFs is "the liquidity provided by the quarterly dealing cycle, which fits in with the pension scheme's operational processes such as fund rebalancing and life-styling, and so on".

And, Seely says, most LTAFs have a "liquidity mechanism", whereby they "hold a portion of assets in a highly liquid asset type, whether that is cash, money market funds or listed equities".

What's more, he adds: "DC schemes, particularly large master trusts, can utilise the semi-liquid nature redemption terms that some of these vehicles offer, to ensure liquidity is carefully managed across their portfolio," he says. "This is something which is not easily achieved if accessing illiquid assets through a conventional drawdown fee model where capital can be locked up for 10 years or more."

Still, the question of illiquidity is one that needs consideration; it can cause understandable concern among trustees. "Despite safeguards, LTAFs may face pressure if redemption demand spikes during market stress and liquidity mechanisms are not adequately managed," Seely says. "Education by providers is extremely important to ensure investor understanding."

The future for LTAFs

Where next for this burgeoning fund? Platforms are already making it simpler to get into LTAFs, and Taylor thinks this trend will continue. "The ease with which LTAFs can be added to provider platforms and included in the default strategy for most DC pension schemes means that LTAFs will be the preferred solution for investing in private markets over the next 12 months," he predicts.

And as demand grows, so too will choice. The FCA fund register shows more than 30 LTAFs in operation today, and Seely believes there will be many more LTAFs, with a push for those focused on "specific themes such as energy transition, social infrastructure, or blended finance". In fact, Schroders now has three LTAFs aimed at pensions, one with a focus on renewables, one on climate and one on UK innovation. And in April this year, Scottish Widows, too, announced plans to launch a new open-architecture LTAF.

Still, given the lack of track record so far, Seely acknowledges that there is work to do. "As a relatively new structure, trustees may remain cautious without in-depth data on performance, liquidity and investor experience," he says.

LTAFs look set to become a mainstay of pension schemes' strategies even so, Taylor says: "As well as the investment opportunity, the ability to provide consistent reporting across a range of asset classes and support trustees with their climate and de-carbonisation targets will make them a natural fit for most schemes."

Written by Sandra Haurant, a freelance journalist