Pensions Advisory

Report to the Pensions & Private Capital Expert Panel

Unlocking capital to achieve benefits for pension savers, the Private Capital industry and the wider UK economy

26 February 2024

pwc

Foreword from the BVCA

Seeking diversified pension returns and new routes to sustainable economic growth.

Meeting the policymakers' challenges

For many years UK policymakers, whether in government, Parliament or at the regulators, have grappled with two separate challenges, which through the Investment Compact and Mansion House processes we are looking to address.

The first is the need to provide decent pensions in retirement for the UK population, with success depending on the role of private pension savings complementing state provision. Achieving this aim in an appropriate way (in terms of cost, value, risk, diversification and other factors) has been at the heart of the pensions industry's efforts.

The second challenge relates to securing sustainable growth in the UK, underpinned by the need for greater private sector investment in the rewiring of the existing economy and the creation of 'the new economy', as new areas such as the energy transition and life sciences offer the UK important opportunities to be internationally competitive. The UK Private Capital industry, comprising venture capital, growth equity and global buyout funds, has been at the heart of these efforts.

Political leaders in government and on the Opposition benches have challenged the two industries to see if a proportion of the pool of pension capital, which is growing substantially in the UK (particularly in defined contribution funds), could be used appropriately by the Private Capital industry to enhance pension savers' returns and invest productively in the UK economy, thus addressing elements of both policy challenges together.

This is not the first time that these questions have been asked, or attempts made to find the answers. We acknowledge all of that work and the expertise we can draw on today, which owes a debt to the serious efforts and policy developments of recent years. All of that provides a significant platform from which to develop this new programme.

Given the cross-party interest in the issues, at the most senior levels, we can see that there is a renewed urgency to the questions being asked of the two industries, and an onus to work collaboratively towards appropriate shared solutions. The commitments in the Mansion House Compact and the Investment Compact were strong public statements from the industries, demonstrating the shared desire to find solutions.

Through the Expert Panel we now seek to understand the issues which these challenges present to both sectors, what can be done to address them and how we can develop shared solutions which do not dilute the primary responsibilities of the principals in the pensions and Private Capital worlds, while finding appropriate answers to the policy makers' questions.

Preparing the ground

Over recent months following the commitments made in the two Compacts, there has been an increased intensity to the discussions between the pensions industry and Private Capital industries, in anticipation of the formation of the Expert Panel, the Technical Expert Group which will support its work, and the wider cross-industry discussion which the Mansion House Forum will facilitate. The constructive tone of those discussions, and the early sharing of ideas, provides an encouraging starting point for the work of the Expert Panel.

To prepare the ground further, we recognised that there should be an effort made to set out how each of the industries currently invests on behalf of pensions savers and other institutional investors, in the case of the Private Capital industry. With a high-level, shared understanding of each industry's structures, and the associated commercial and regulatory drivers, we judged that we would have a better chance of seeing the challenges from each industry's perspective, develop a good grasp of the key issues to address and, it is hoped, a clearer insight into the best routes to shared solutions to the policy makers' challenges.

Foreword from the BVCA

To that end, the BVCA commissioned PwC to work with us to prepare this report which is designed to set the scene for the Expert Panel's work, offering a high-level overview of the starting points for both industries and a lens through which to identify the key issues for the Expert Panel to work through, supported by the Technical Expert Group and others as appropriate en route to the shared solutions.

We are grateful to the firm and the wide cast of experts brought into the process. We have made this report public to allow a wider range of stakeholders to see how the commitments under the Investment Compact are being taken forward.

Meeting the policymakers' challenges

The urgency of the challenges from the policymakers, and their clear interest in the work we are taking forward, makes it important that there are clear milestones to the work of the Expert Panel. The Budget in March and the anniversary of the Chancellor's speech at Mansion House, where the Mansion House Compact was unveiled, are two key moments in the year.

In addition, the pensions and Private Capital conference which was committed to under the Investment Compact, is being planned for early September 2024. At each milestone we want to be able to show how the Expert Panel is progressing and, by the time of the conference, to have a clearer idea of what appropriate shared solutions could look like.

We hope that this report provides a valuable starting point for all the work that will follow.

Michael Moore, BVCA Chief Executive

February 2024

Scope of the PwC report

Important notice

This report has been prepared for the BVCA and solely for the purpose and on the terms agreed with the BVCA (as set out in our engagement letter dated 11 January 2024) and cannot be relied on by anyone else. It does not constitute professional advice, and anyone other than our client should not act upon the information contained in this report without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this document, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of anyone acting, or refraining to act, in reliance on the information contained in this report or for any decision based on it.

Scope of the PwC report

This report provides an overview of how funds flow from the defined contribution ("DC") pension schemes into the Private Capital markets and the key features of the structures used to facilitate the flow of those monies.

The British Private Equity & Venture Capital Association ("BVCA") is the industry body and public policy advocate for the following types of firms in the UK.

- **Venture Capital (VC)**: Firms managing funds that typically take minority stakes in innovative companies with very high growth potential in their early stages of development. VCs are active owners who are focused on high growth potential. They provide expertise and capital, the latter proportionate to the risk/return appetite and needs of the business for the stage it has reached, from developing products and services at the earliest stages, to becoming established businesses which can then be scaled.
- **Growth equity (GE)**: Firms managing funds that typically make private equity investments which secure control of the business (but can also include minority investments) in mature companies. This active ownership model provides primary capital and expertise which allows the portfolio company to grow substantially through expansion, by applying global standards to transform operations, and by opening up new opportunities, such as entering new markets, to accelerate the growth of the business.
- **Global buyout (GB)**: this category of firms (who are not the primary focus of the Compact, but included for completeness, as they are a significant proportion of the UK Private Capital industry) manage funds that use the active ownership model to take control stakes in larger, more established companies, often through a buyout transaction (as a carve out from a conglomerate or by acquiring businesses from the public markets). As with 'growth equity', the fund provides a company with access to capital and strategic and operational expertise to boost its growth and profitability.

These three groups have similar, but different perspectives and objectives. For ease throughout this report we refer to these three groups collectively as Private Capital firms ("PC").

Following the Mansion House speech by the Chancellor of the Exchequer in July 2023, the signing of the Mansion House Compact (the "Mansion House Compact"), the Government's Autumn Statement in November 2023, and the signing of the Investment Compact for Venture Capital and Growth Equity (the "Investment Compact"), the BVCA is working to support the Government to understand the options available to establish mechanisms to bridge the gap between capital invested in UK pension schemes, DC in particular, and UK Private Capital firms. As part of its role, the BVCA has committed to a range of measures to support the objectives of the Investment Compact, including to work with the wider industry to establish a Pensions & Private Capital Expert Panel (the "Expert Panel").

PwC ("We") were commissioned by the BVCA to prepare this report which was presented to the Expert Panel. The purpose of this report is to ensure that there is a shared understanding amongst the representatives on the Expert Panel, and the broader market, of the key structures currently used by the pensions and Private Capital industries, as well as the key considerations for making these or new structures work for DC investment in Private Capital funds.

This report is not intended to be a comprehensive review of every structure in the market, but instead, provides an outline of the key structures available in order to provide the basis for a discussion on how to adapt existing structures, or design and develop new structures, and share best practice. After consultation with the BVCA and our own in-house specialists, we have endeavoured to comment on those structures most widely used and available in the market and in development.

We have drawn the information contained in this report from a number of different sources. Wherever possible we have referenced the source of our data and information. As part of putting this report together, we have where appropriate, incorporated changes and suggestions from the Technical Expert Group set up by the BVCA.

Proposed topics for the Expert Panel and TEG to examine further

Addressing the challenge of the Investment Compact requires the cooperation of both the Private Capital and Pensions industries in order to overcome both demand and supply-side issues.

The Expert Panel met for the first time on 13 February 2024 to share its views. We set out below a suggested list of topics and questions for the Expert Panel to consider for that meeting in order to a) establish a common understanding of the issues and challenges in both the Private Capital and pensions industries, and b) to create a work plan in order to meet the objectives of the Investment Compact.

1. **Pension stakeholder engagement and education** - what needs to be done to build trust and knowledge amongst pension stakeholders (e.g. members, trustees, employers and key influencers/intermediaries) to give them the confidence to invest in Private Capital (or demand that their pension provider makes more Private Capital options available)?
2. **Pension stakeholder understanding and transparency** - what information is needed and how should it be provided to enable pension stakeholders to choose, manage and monitor Private Capital investments, and in particular the return, cost and risk associated with that investment?
3. **Time horizon** - can the current time horizon for investment returns to pension members (e.g. default lifestyle funds that typically disinvest into predominantly cash and fixed interest assets from the age of 55) fit in with the time horizon and liquidity characteristics for returns from Private Capital (liquidity of assets, availability of valuations and ease of entering/exiting investments), or does there need to be a change in approach to managing and balancing risk and returns in order to efficiently deliver retirement income for pension savers?
4. **Market infrastructure**
   a. Pensions trusts commonly use bundled solutions from life platforms to provide investment options to members. Do these present a blocker to achieving the objectives of the Investment Compact? If so, are there modifications or adaptations that could be implemented for these to be overcome?
   b. Where there are existing Private Capital structures (existing or emerging) are these suitable for facilitating a greater share of DC pension assets into Private Capital?
   c. Taking a. and b. into consideration, is a new Private Capital or pensions structure/arrangement required? If so, what is required from the Private Capital and pensions industries in order to facilitate this?
5. **Returns -** exploring the returns track records for both pensions and Private Capital funds; and the opportunities available through portfolio diversification involving private capital.
6. **Net value -** what information is needed for Private Capital firms and the pensions industry to demonstrate net value to pension stakeholders? What broader factors need to be taken into account when considering 'value' e.g. ESG characteristics, value to wider UK economy?
7. **Legislation, regulation and policy (including TPR, FCA, PRA)**
   a. Are amendments to existing legislation or regulation (or professional guidance and standards) required to facilitate a greater share of DC pension assets into Private Capital? For example, the charge cap on default funds, Solvency II requirements, Permitted Links, Consumer Duty, amongst others.
   b. Is new legislation or regulation required?
8. **Features from other pension systems** - what features from other pension systems (e.g. internationally) should be considered and potentially incorporated into the UK system that would facilitate a greater share of DC pension assets into Private Capital?
9. **Additional issues**
   a. Are there material issues that are not included above or require more explanation in order to establish a common understanding across the Expert Panel?
   b. Are there alternative options (either in existence or emerging) that are not covered in this report that the Expert Panel considers worthy of exploration and debate in order to meet the objectives of the Investment Compact?

Key messages

Automatic enrolment has fundamentally changed the pensions landscape with growth in the number of members contributing to their DC Schemes and the assets held by DC Schemes. However, member engagement continues to be low and choice and outcomes can be improved further; this may require a fundamental change in demand-side factors.

Introduction

Over the last 10 years the DC pensions landscape has fundamentally changed

- The introduction of auto-enrolment means that an additional 11 million employees are saving into pension schemes in 2021 compared to 2012; and
- The assets under management within DC Master Trusts has grown from c. £10bn in 2017 to £105bn in 2022[1].
- Despite greater participation there is a 'savings gap' between what is being saved and what is required. The current PLSA 'Retirement Living Standards' estimates that to have a 'moderate' retirement requires a single person to have an annual income of £31,300 or £43,100 for a couple. Whilst the state pension will cover some of these costs (2023-24 £10,600 p.a.) the remainder will need to come from other savings, and for reference the average member pot in a Master Trust (albeit these are relatively new arrangements) is c.£6,000 in total.
- In the 2022 a PLSA report estimated that only 35% of households currently saving into a DC pension were on track to meet the 'moderate' level of retirement standard (based on the 2022 equivalent).

Although we have a well developed and sophisticated private equity and Private Capital market in the UK, the UK invests fifteen times less in start-ups and growth businesses than Canada, nine times less than the USA, and four times less than Australia.

As a result, the Private Capital market has access to an insufficient domestic capital base when raising new funds. The knock-on effect of this is that investment opportunities in the UK may not be fully funded, funded by foreign investors or completely miss funding overall, leading to a potential loss of value from a Private Capital perspective, as well as for the UK as an economy as a whole.

In particular, the proportion of pension assets invested in UK unlisted equity remains low - the City of London Corporation estimates that only 0.5% of UK DC assets are invested in unlisted equities.

To help address this, under the Mansion House Compact, 11 of the largest DC funds committed to allocate at least 5% of their DC default funds to unlisted equities by 2030. This is expected to have the dual benefit of:

- Improving member outcomes for pension savers; and
- Providing investment capital to stimulate growth in UK productivity.

Key issues impacting investment decisions

However, there are a number of demand side and supply side factors that would need to be addressed in order for the objectives of the Mansion House Compact to be achieved. The existence of these factors may also explain why there isn't a greater proportion of pension assets invested in Private Capital.

Demand side factors

Ideally over the longer term, demand for more sophisticated investment options should come from members (e.g. those who ultimately benefit from higher returns). Currently corporates and trustees are responsible for decision making on investment strategy (effectively they are stepping into the shoes of the member) and they have a number of often competing priorities to take into account.

If members are able to express their demand they will need:

- access to advice and guidance which currently is scarce other than for the more wealthy demographics; and
- transparent information on investment performance, costs, charges and quality of service. The Government, together with the FCA and TPR, is attempting to address this via the Value for Money initiative, but the practical implementation is still subject to further consultation by the FCA in 2024.

We note that currently the decision-maker is a combination of the trustee, an Independent Governance Committee (IGC) or the investment consultant; empowering more savers to engage with their own investment decisions will take time, and we note that there are some savers who may always prefer for the responsibility of choosing their investments to be done by others.

1 - TPR Scheme return data

Key messages

Many pensions schemes use life platforms which can be restricted, to some extent, by regulation. As the scale of pension investment grows providers could establish their own infrastructure enabling greater choice and flexibility.

Key issues impacting investment decisions (cont.)

In addition, existing DC pension schemes have some inherent barriers to investment in Private Capital as a result of the need for the member to have liquidity if they were to exercise their option to move their funds as well as liquidity at retirement (exacerbated by the majority of members not exercising positive choice and being defaulted into a lifestyle type fund which typically starts an automatic disinvestment into predominantly cash and fixed interest assets from around the age of 55).

The introduction of a new type of pension scheme called a Collective Defined Contribution (CDC) scheme may provide greater capacity to invest in Private Capital as a result of a longer-term investment horizon and potential additional flexibility to manage liquidity compared to an individual member in a DC pension scheme. However, to date there is only one CDC scheme which has advanced to the later stages of implementation.

Supply side factors

Pension trusts offer the most flexibility for the provision of pension benefits including flexibility over investment options. However, due to the lack of scale previously, most pension trusts have used bundled solutions from life platforms for practical implementation. Life platforms have their own commercial imperatives (for example, cost of capital for investment in systems which can accommodate non-daily pricing) and competitive pressures which may not align perfectly with trustees' or members' interests or desire for innovation. In addition, they are regulated by the FCA and include restrictions as a result of their retail nature, as well as being subject to Solvency II requirements of the life insurer.

The Government's ambition (in conjunction with enabling legislation, including the Value for Money initiative) is for the UK DC pension scheme market to consolidate into a smaller number of larger pension providers. One of the benefits of scale will be that Master Trusts could establish their own infrastructure rather than using a bundled solution from a life insurance company with the potential to increase investment flexibility, reduce costs (at scale) and increase the Master Trust's ability to tailor the pension provision to member / decision maker demands (that is not to say that life insurers cannot also leverage the benefits of scale and continue to use life platforms and unit-linked funds; indeed Master Trusts may continue to choose to use life platforms alongside in-house or bespoke infrastructure, however as Master Trusts scale up they may have more capacity for change).

To facilitate the demand for Private Capital investment from DC pension schemes (whether current or future), it is important for there to be a product that the pensions industry can understand, as over recent years there has not been a product that resulted in an optimum fit. The introduction of the Long Term Asset Fund ("LTAF") in 2021 could be part of the solution. These were designed to provide easier, simpler access for DC investors and is a "conditional permitted link" which can be helpful where it is offered through a life platform / unit linked product. Whilst we understand that take-up of this to date has been low and it is too soon to provide a view of LTAFs as a longer term solution, we understand that interest has accelerated since the Mansion House Compact.

Finally, to date, providers have typically competed on fees rather than performance net of fees. This has potentially resulted in providers biasing their investment choices to those with lower costs. As we look forward over the next ten years to a potentially higher inflationary, lower growth environment the need for more sophisticated (and potentially more expensive) investment options will be more critical for the outcomes of pension savers. Pension providers will therefore need to adapt to a new environment of competition on performance net of fees and also find new ways to engage with savers so that they understand the potential for greater returns for higher costs.

The introduction of the annual charge cap of 0.75% for automatic enrolment default funds while aiming to protect members has, to an extent, also driven a focus on cost rather than value and member outcomes. This charging structure is also inconsistent with the typical charging structure for Private Capital investments, albeit, the exclusion of performance fees in the charge cap definition provides some flexibility.

Key messages

Conclusion

To make a substantive change in the proportion of pension assets invested in UK Private Capital the questions set out on page 6 will need to be addressed as well as addressing the broader demand and supply side issues. Alongside this there will be a need for a supportive regulatory environment and a need for the pensions industry to take advantage of the opportunities that become available as the DC market gains greater scale - particularly from the growth of Master Trusts.

This will enable those larger schemes to find innovative solutions to the issues identified and ultimately to make a greater level of investment in Private Capital. Whilst good progress has been made on a number of these issues already, key stakeholders and influencers in both the Private Capital and Pensions industries will need to work collaboratively with each other in order to make substantive progress by 2030.

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The Mansion House Compact and Autumn Statement

In 2023 the Government announced reforms to boost pension savings and increase investment in British businesses by increasing the proportion of DC default funds invested in unlisted equities to 5% by 2030.

Mansion House Reforms - July 2023[1]

The Chancellor's 'Mansion House Reforms' announced on 10 July 2023 are aimed at boosting pension savings and increasing investment in British businesses. The reforms aim to do this by unlocking capital from DC pension schemes for investment in high growth companies.

The Government's analysis comments that:

- The reforms could help increase pension pots for an average earner who starts saving at 18 by 12% (or c.£16,000) over their career - this equates to an additional £1,000 per year in retirement.
- Up to £50bn of investment in high growth companies could be unlocked by 2030 if all UK DC pension schemes followed suit.

The Mansion House Compact

11 of the UK's largest defined contribution pension providers have committed to take action to secure better financial outcomes. These providers represent over £400 billion in assets and the majority of the UK's DC workplace pensions market.

The defined contribution providers have committed to meaningful action within 12 months to:

- "increase the proportion of UK pension and other relevant assets, including DC default funds, invested in unlisted equities; and
- To allocate at least 5% of DC default funds to unlisted equities by 2030 in a way that is consistent with the requirement to act in the best interests of their savers".

1. https://www.gov.uk/government/news/chancellors-mansion-house-reforms-to-boost-typical-pension-by-over-1000-a-year
2. https://assets.publishing.service.gov.uk/media/6568909c5936bb00133167cc/E02982473_Autumn_Statement_Nov_23_Accessible_Final.pdf

Challenges

The Mansion House Compact also noted the issues and enablers that would be needed to help achieve the commitment:

- "The long-term support of the Government, and of the relevant regulatory authorities - noting the recent and ongoing initiatives on pension reform, and the requirement for further policy, legislative and regulatory changes to not only address the technical barriers that hinder investment in unlisted equities at scale but also the immediate and broader structural challenges.
- A progressive set of reforms could include incentives, addressing fragmentation, enhancing operating frameworks and facilitating a sustained cultural shift to risk and reward to further embed the principle that the future financial interests of UK long-term savers is a result of maximising risk adjusted net returns, including value over cost, to deliver better outcomes".

Autumn Statement - November 2023[2]

The Chancellor's Autumn Statement on 22 November 2023 reiterated the messages from the Mansion House Reforms and specified the initial steps that were being taken in the industry:

- There were two further signatories to the Mansion House Compact taking the total number from 9 to 11 (October and November 2023);
- the launch of the British Private Equity and Venture Capital Association's Venture Capital Investment Compact for Venture Capital & Growth Equity (24 October 2023, see following page);
- The Mansion House Pension Summit on 25 October 2023 with a speech from the Pensions Regulator ("TPR") supporting the Mansion House Reforms and from the Chancellor supporting the Investment Compact; and
- The publication of the Government's response to the 'Pension trustee skills, capability and culture: a call for evidence' which emphasised the scope for better support, education and understanding in order to facilitate the best outcomes for pensions savers.

The Investment Compact for Venture Capital and Growth Equity

The BVCA launched the Investment Compact to establish an Expert Panel to support the Private Capital and Pensions industries in achieving the aims of the Mansion House Compact.

The BVCA, with the support of the Government, launched the Investment Compact for Venture Capital & Growth Equity (the "Investment Compact"), on 25 October 2023[1], building on the Mansion House Compact of July 2023.

The Investment Compact sets out a commitment by UK venture capital and growth equity fund managers to strengthen partnerships with UK pension investors to help facilitate investment by DC and other pension funds into venture capital and growth equity funds, with a view to building Private Capital investment for the future.

According to the City of London Corporation, only 0.5% of UK DC pension assets are invested in "unlisted equities" which covers a broad range of unlisted asset classes (including certain AIM equities), and venture capital and growth equity funds.

The Investment Compact

The Investment Compact has over 100 signatories, representing some of the UK's leading venture capital and growth equity fund managers, with over £100bn of Assets Under Management ("AUM") covering different sectors, stages, and strategies (the Investment Compact has the full list of signatories, see footnote).

The Investment Compact

Signatories have committed to:

- "Attracting UK pension funds as limited partners into the funds they manage or advise.
- Partner with pension investors to consider how they can produce effective investment structures to suit their needs to allow allocations to funds in the interest of savers.
- Share best practice/rules of engagement for working in private markets with DC schemes, particularly trustees and their consultants/advisers".

Challenges

As with the Mansion House Compact the Investment Compact notes:

- "The long-term support of the UK Government, and of the relevant regulatory authorities - noting the recent and ongoing initiatives on pension reforms…"
- "To unlock capital and achieve benefits for pension savers, venture capital, growth equity and the wider Private Capital industry will need to continue working with the pension industry to develop effective investment structures and precipitate joining action".

Actions from the BVCA

The BVCA has committed to undertake the following actions to ensure that significant progress is made within 12 months of the signing of the Investment Compact:

- "To work with the wider industry to establish a Pensions & Private Capital Expert Panel to develop effective investment structures and share market best practice and produce guides/reports;
- To develop events to connect pensions investors with Private Capital fund managers and highlight potential investment opportunities;
- To work with the pensions industry to create training programmes and best practice documents to develop greater understanding of the Private Capital industry; and
- To report progress from the BVCA members in attracting UK DC pensions assets into the funds they manage or advise (to the extent possible and subject to confidentiality)".

1. Link to Investment Compact

The role of the Expert Panel

The Expert Panel will build relationships across the industries; provide updates to stakeholders and Government; drive forward issues and workstreams; and promote engagement and outcomes.

Purpose

As set out on the previous pages, the Expert Panel will underpin a partnership between the UK pension and Private Capital industries to deliver the commitments set out in the Investment Compact.

Objectives

The Expert Panel aims to advance the Mansion House Compact. The Expert Panel will foster a constructive relationship between the pensions and Private Capital industries and provide strategic oversight and accountability on the work required to fulfil the Investment Compact's objectives. This will include:

- Addressing the issues which currently limit investment in Private Capital funds;
- oversee and report on the project work and outcomes to stakeholders;
- agree and steer the main issues and workstreams;
- engage and liaise with the Private Capital and pensions industries to improve understanding, alignment and focus on shared outcomes.

The Expert Panel will mainly focus on UK DC schemes, but may also consider private Defined Benefit ("DB") and Local Government Pension Schemes ("LGPS") if relevant.

Reporting

There are three work streams for reporting:

1. **Public reporting** - the Expert Panel will monitor and report on the Investment Compact's commitments to boost Private Capital investment in the UK. It will publish a report in September 2024 at a conference to industry representatives and stakeholders, and interim reports around the Spring Budget and the Mansion House speech.
2. **Stakeholder reporting** - Updates will be provided to HM Treasury and other stakeholders, such as the City of London Corporation, on ongoing progress.
3. The BVCA will **report to the Expert Panel** on industry progress in deploying UK DC capital.

The outputs of the three work streams will include reports, guides, events and policy suggestions. The Expert Panel will set the criteria and indicators for success.

Membership

The Expert Panel will include around fifteen representatives from the Private Capital and pensions industries, trade associations and advisers. The term of the Expert Panel, Mansion House Forum and Technical Expert Group will run from early 2024 to Spring 2025, meeting on (approximately) a quarterly basis.

Structure

Expert Panel

The committees will be asked to provide feedback, support and advice by the Expert Panel as and when appropriate.

Mansion House Forum

Comprised of the signatories to both the Mansion House Compact and the Investment Compact. It provides oversight of the alignment of the common objectives of the two compacts. The forum will issue a statement to key stakeholders such as HM Treasury and the City of London Corporation to provide an update on the progress of the Expert Panel and Technical Expert Group.

Technical Expert Group

Comprised of the trade associations, private capital firms, DC pension providers, advisors and others. It will consider three key workstreams:

1. Structures across both the Private Capital and pension industries;
2. Technical issues; and,
3. Engagement such as training, outreach and events.

BVCA Committees

Comprised of the BVCA Technical Committees, Venture Capital Committee, Limited Partner Committee, UK & European Committee and Global Capital Committee. These groups will be asked to provide additional technical expertise and insight, as required.

Background to Pensions and Private Capital landscape

02

DC Pensions landscape - current estimate (2022)

Savings in DC pension schemes has grown rapidly over the last decade driven largely by automatic enrolment and the closure of Defined Benefit schemes.

In the illustration below we have drawn on data from a variety of sources to provide an estimated view of the DC market place. This view does not seek to be definitive but an illustration for the reader, and, as such, we have rounded numbers. We note that the requirements for data to be collected and recorded varies across the different pension arrangements, for example, data collected on Master Trusts by TPR may not be directly comparable to the data collected on personal pensions by the FCA. It is worth noting that some members will have more than one pension arrangement.

- **The UK DC Pensions market was estimated in 2022 to have c.£1.8 trillion of assets[3].**
- **Of this c.£540bn were estimated to be in drawdown or annuities which we have excluded from our illustration as not being the target for investment in illiquid assets.**
- **A further c.£500bn - £800bn is in personal pensions and SIPPs over which the pensions and Private Capital industries have less influence.**
- **As a consequence, the focus of this report is on workplace pensions - predominantly the Master Trust and contract based markets (highlighted).**
- **These two markets have in the region of c.£360bn - £425bn and are expected to continue to grow rapidly.**

Institutional/workplace - £550bn - £600bn[3] (estimated to be c.50% of all employees)

'Direct to saver- individual personal pensions/SIPPs
- £500bn - £800bn[3]
- c.19m members

Trust based

Contract based - £260bn - £300bn
c.12m members[1]

Signatories to the Mansion House Compact provide a number of the pension arrangements shown here - for example a number of the signatories provide contract based pensions such as a Group Personal Pension (GPP), Self-invested Personal Pensions (SIPP) and have a Master Trust offering (Trust based pension)

Master Trusts - c. £100bn - £125bn
c.24m members[2]

Non Master Trust, Micro Schemes and Hybrid

1 - https://www.fca.org.uk/news/press-releases/fca-tpr-outline-framework-value-money-defined-contribution-pension-schemes
2 - https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2022-2023
3 - https://www.theia.org/sites/default/files/2023-10/Investment%20Management%20in%20the%20UK%202022-2023%20-%20Chapter%204.pdf

DC Pensions landscape - looking forward (2030)

Most DC growth is expected to be in Master Trusts, with assets in those providers estimated to grow 3 - 4 times by 2030, such that DC becomes the largest type of pension provision overtaking Defined Benefit.

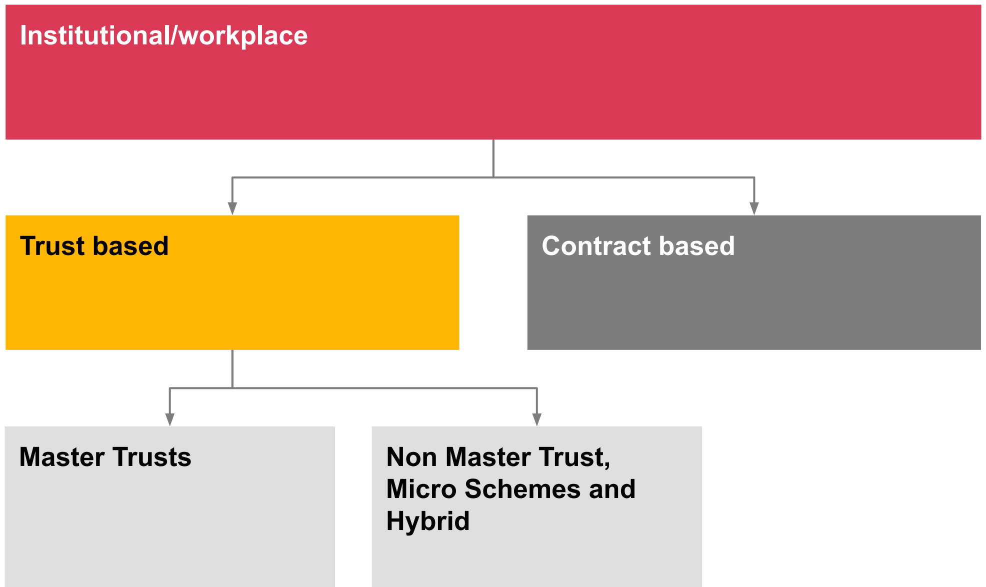
Automatic-enrolment has resulted in an additional c.11m employees being enrolled in a pension scheme in 2021 compared to 2012 and a significant amount of future growth is expected to come from these members and the schemes they are in.

Most members of DC trust-based pension schemes are in Master Trusts. Master Trusts account for 90% of all memberships (23.7m out of 26.4m) and 95% of active memberships (10.0m out of 10.5m).

Data from both the Pensions Policy Institute (PPI) and the DWP estimate that the workplace DC market could have c.£800bn of assets in 2030 (in real term) (this assumes MTs grow to c. £420bn and there continues to be growth, albeit slower than in MTs, in the Contract based market, increasing to c.£350bn - £400bn).

At the time of writing and taking into account publicly announced mergers and acquisitions, there are c.30 Master Trusts in the market. With further consolidation this number is expected to decrease further.

DWP analysis estimates that the trust-based market could grow from around £130bn in 2023 to about £420bn in 2030 in real terms. Much of this growth would come from the largest Master Trusts, with the five largest potentially holding around £300bn in assets.



The number of micro schemes has reduced from over 3,500 schemes in 2012, to 1,220 non-micro schemes at the start of 2023, and TPR data estimates that this could reduce further to c.500 schemes by 2030 as many are expected to transfer into Master Trusts.

Data for the contract based market is not as readily available as for Trust based. However, the largest contract based providers are also Master Trust providers and with continued market consolidation it is likely that by 2030 many savers will be in schemes with providers managing in excess of £30bn either through contract or Master Trusts or both.

Sources:
https://assets.publishing.service.gov.uk/media/655c8ff7d03a8d000d07fda2/trends-in-the-trust-based-private-pensions-market.pdf
https://www.pensionspolicyinstitute.org.uk/media/xfybvxtq/20230926-the-dc-future-book-9-2023.pdf
https://assets.publishing.service.gov.uk/media/6575970958fa30000db141c5/evolving-the-regulatory-approach-to-master-trusts.pdf

DC Pensions landscape - the need for greater returns

Despite greater DC participation there is a significant savings gap between the amount being saved and the amount required for retirement; improving investment returns is critical to reducing the gap.

Per the Mansion House speech in July 2023 the Government has an objective to secure the best possible outcome for pension savers. This includes:

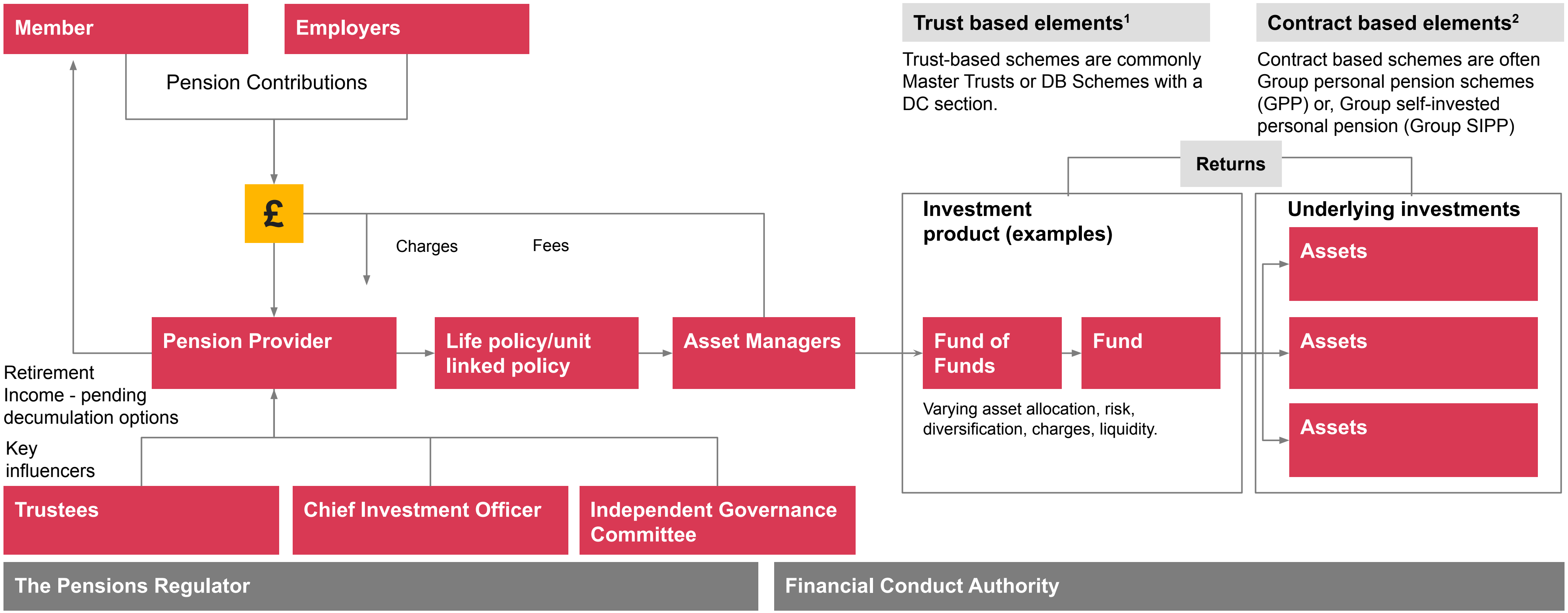
- Continuing to build on the success of Automatic Enrolment ("AE") and member engagement in pension saving. AE has seen 10.9 million employees automatically enrolled, 88% of eligible employees participating in a pension, and £33bn more (in real terms) being saved into workplace pensions in 2021 compared to 2012.[1]
- However, despite greater participation there is a 'savings gap' between what is being saved and what is required. A 2022 PLSA research report[2] estimates that when measured on a household basis, few are currently on track to hit the target replacement rates used by the Pensions Commission[4] to benchmark savings adequacy. Amongst the whole population (i.e. approximately 17 million households) 51% will not achieve their target replacement rates.
- The current PLSA 'Retirement Living Standards'[3] estimates that to have a 'moderate' retirement requires a single person to have an annual income of £31,300 or £43,100 for a couple. Whilst the state pension will cover some of these costs (2023-24 £10,600 p.a.) the remainder will need to come from other savings. The 2022 PLSA report estimated that only 35% of households currently saving into a DC pension were on track to meet the 'moderate' level of retirement standard (based on the 2022 equivalent).
- To close the savings gap greater focus on performance and net investment returns is required.
- Supporting analysis to the Mansion House speech shows that over a five-year period there can be as much as 46% difference between the best and worst performing pension schemes. This means that a saver with a pot of £10,000 could have notionally lost £5,000 over a 5-year period from being in a lowest performing scheme.
- To the extent that savers can access higher returns from their investments it can:
  - Increase the number of households that meet the estimated retirement living standards, particularly at 'minimum' and 'moderate' level.
  - Improve retirement standards further where the 'minimum' and 'moderate' retirement living standards are being met.
  - Reduce the strain on the period required for saving and / or the amount required to be saved.

1. Trends in the Defined Contribution trust-based pensions market - DWP - 22 November 2023
2. https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Research-report-supplement-to-Five-Steps-to-Better-Pensions.pdf
3. https://www.retirementlivingstandards.org.uk/
4. Replacement rate is the ratio of an individual's income after and before retirement, e.g. income in retirement expressed as a percentage of income before retirement.

Simplified overview of DC funds flow - a workplace pension

Workplace pensions provide the pensions for a majority of the population. Whilst there are differences between a Trust based and Contract based arrangement there are a number of similarities between them.

The chart below sets out a high-level view of how funds flow in a generic workplace based DC pension. There are variations on this which are covered in the Investment Structures section of this report.



1. Trust-based schemes - Occupational pension schemes that are established under trust, and that have trustees. Regulated by TPR.
2. Contract-based schemes - Pension schemes that are established by insurance companies or other specialist providers where there are direct payment arrangements are often called contract-based schemes. Under these arrangements there is a contract between the provider and the member but the employer is not a party to the contract and there are no trustees. The scheme, if set up for a particular workplace, may be given the name of the employer or group, but this doesn't mean that the employer is a party to the scheme. Regulated by the FCA, however, the FCA can also have regulatory responsibilities for firms that provide products and services for pension schemes that are regulated by TPR, e.g. advice and asset management.

- Definitions sourced from TPR Trustee Toolkit

Private Capital landscape

The commentary below has been provided by the BVCA and sets out how the Private Capital industry is structured and the value it brings to the UK economy.

How private capital is invested

Private capital funds pool money from multiple institutional investors around the world. This can range from international pension funds, sovereign wealth funds or insurance companies, to local authority pension schemes, family offices or university endowments. In 2022, BVCA members in venture capital and growth equity raised a total of £8bn across 74 funds.

Private Capital funds are invested according to the following broad strategies:

Venture Capital

Venture Capital represents firms managing funds that typically take minority stakes in innovative companies with very high growth potential in their early stages of development. VCs are active owners who are focused on high growth potential. They provide expertise and capital, the latter proportionate to the risk/return appetite and needs of the business for the stage it has reached, from developing products and services at the earliest stages, to becoming established businesses which can then be scaled. Venture Capital funds can hold their investments for long periods, over 10 years in some instances.

Growth equity

Growth Equity represents firms managing funds that typically make private equity investments (including some minority investments) in relatively mature companies that might be looking for primary capital to expand and improve operations or enter new markets to accelerate the growth of the business. Growth equity deals involve taking control of the business where the management team implements a plan to drive growth and make operational improvements. Hold periods are typically 4-6 years.

Global buyout

Global Buyout, although not the primary focus of the Investment Compact but included here for completeness, represents firms managing funds that typically take controlling stakes in larger, more established private companies, or acquire businesses from the public markets through a buyout transaction. In the same way as growth equity, an investment by a Global Buyout fund provides a company with access to capital and strategic and operational expertise to boost its growth and profitability.

There are various ways that a private capital fund will generate returns through the sale of a business at the end of the holding period. These include a "trade sale" to another company, sale to another financial investor such as another private capital fund, or an IPO.

Private Capital landscape

The commentary below has been provided by the BVCA.

Invested in a better future

The UK is home to a dynamic venture capital and growth equity industry with a strong track record of investment and returns. A total of £8bn was raised by 74 venture capital and growth equity funds in 2022 according to BVCA data, and UK government research shows that £22bn of venture capital was deployed across the UK in 2022, making the UK the second most active and capital-intensive venture capital market in the world, after the US.

Overseas investors have recognised the opportunity and benefits that investing in innovative UK businesses can provide pensions savers. It is crucial that UK pension savers also have the same opportunity to benefit from these returns. The partnership delivered by the Expert Panel and the Technical Expert Group aims to enable UK pension schemes to access these returns for their members while helping UK businesses grow.

This is an asset class that has historically generated good returns and added diversification to investment portfolios. Evidence from a British Business Bank study showed that investment by DC scheme default funds in venture capital and growth equity assets could achieve a 7-12% increase in total retirement savings for the average 22 year old[1]. BVCA research has found that UK venture capital and growth equity funds generated IRRs of 16.7% and 12.8%, respectively over the 10-year horizon period to December 2022[2]. This compares to the 6.5% return delivered by FTSE All-Share and the 6.3% return delivered by the FTSE 100 index over the same time period.

Invested in growth across the UK

The UK private capital industry provides a valuable economic contribution to the UK - there are 2.2 million people who are employed in private capital backed businesses. In 2022, the Private Capital industry invested £27.5bn in 1,600 UK companies, of which 9 in 10 were small or medium-sized businesses. These businesses directly generated 6% of total UK GDP. Private Capital investment into UK tech-focused businesses totalled £13bn in the same year, representing 47% of the UK investment total[3]. Private Capital is invested across all sectors, including some of the most innovative businesses that are developing solutions to some of the most complex social and economic challenges of our time, in areas such as life sciences and deep tech. With a majority of companies that received private capital investment situated outside of London, the contribution this industry makes to developing businesses across the nations and regions of the UK is an essential contributor to developing economic growth.

Private capital adds value to a company in a variety of ways. Thorough due diligence highlights a company's strengths and weaknesses alike, and with it comes a sound initial investment rationale. By investing in growth sectors as well as focussing on new markets, private capital investors can focus on creating better revenue generation and implementing programmes that make the business more efficient.

The Private Capital investment model involves a structure in which both the Private Capital firm and portfolio company management teams share a common ownership vision, and are motivated to maximise value. Active ownership, effective organisational change and powerful incentive schemes are key to a hands-on investment model that includes rigorous oversight, defined goals and timing, disciplined decision-making and deep resources to match. Ultimately, this approach leads to many companies backed by Private Capital to outperform similar publicly-owned companies with relative benchmarks.

1. BBB/Oliver Wyman report – The Future of Defined Contribution Pensions: Enabling Access to Venture Capital & Growth Equity 2019
2. 2022 BVCA Performance Measurement Survey in association with PwC. Growth Equity calculated as Small and Mid-Private Equity in this dataset
3. Private capital: rising to the challenges of turbulent times: BVCA Report on Investment activity (July 2023)

DC investment in Private Capital - issues and challenges

03

DC investment in Private Capital - issues and challenges

To date, low engagement from DC members and the slow pace of change for industry wide pension initiatives has meant there has been little direct 'consumer' demand for providers to react to.

We have set out below a summary of some of the issues and challenges that could explain the relatively low investment in Private Capital by UK DC pension schemes

'Consumer' demand (including members, trustees, employers, providers)

In DC pension schemes (as they are currently constructed), the pension member has two main choices in relation to their saving – how much money they pay and where the total payments made are invested. In the absence of any positive choice being made in workplace pension schemes (as opposed to individual personal pensions and SIPPs), a default level of contributions and default investment option is applied. This default-type approach is referred to as auto-enrolment and has been in place since 2012.

Over that period, experience is that the majority of pension members make no active decision and remain with the default investment option (although the percentage varies by pension scheme and is influenced by factors such as quality of communications, engagement programmes and the demographic of the pension scheme membership).

As a result of the lack of positive decision making by DC pension scheme members, there has been little explicit demand placed on either employers (who are responsible for procuring workplace DC schemes) or pension providers (who provide workplace DC pension schemes) in relation to specific asset classes, return criteria as well as other features of the pension scheme. As a result, the supply of workplace savings has not had to adapt to member demands in relation to Private Capital. Although we recognise that expecting all members to actively engage in pension investment decisions would be a big step, better member engagement (with targeted guidance/support) is going to be key in helping individuals with decision making around how much to save, when to retire and managing their pension savings in retirement.

Some of the issues which may have contributed to (or may influence in the future) 'consumer' demand for investment in Private Capital

Shortage of advice/guidance services for individuals other than for the more wealthy demographics

Historically, as defined benefit schemes were the dominant form of retirement provision, there was less of a need for individuals to access external help and support as a result of the lack of decisions required on their part.

As DC pension schemes have become more prevalent, the need for individuals to have explicit support has become more important as a result of the decisions they need to make during their accumulation phase, as well as at the point of retirement. It has been recognised that there is a general lack of support available other than for the more wealthy demographics.

As an example, the FCA has recently published a consultation paper on proposals for closing the "advice gap" - the difficulty members face is in identifying that they need support and accessing said support in managing their finances.

In order to equip savers to make positive demands in relation to their pension savings, there will be a need in the future to not only address the shortage of advice/guidance services but also to provide clear, objective and easy to access information in relation to pension saving, pension performance and the implications of the different investment options available. Two specific initiatives which have been designed in this regard but have not yet been implemented are pensions dashboards and the Government's new Value for Money initiative.

Further delays to pensions dashboards

The pensions dashboard programme was launched in the 2016 Budget with an objective of enabling individuals to access their pensions information online, securely and all in one place. This would include simple information about an individual's multiple pension savings, including their State Pension. The original target date for go-live was 2019 but there have been delays and the latest expectation is that dashboards will not be rolled out until late 2026. One of the original expectations was that pensions dashboard providers would be able to offer personalised digital advice to enable savers to obtain a better understanding of their retirement provision and take proactive steps, including increasing contributions, consolidating pensions and understanding investment options.

DC investment in Private Capital - issues and challenges

As DC pension provision overtakes DB, the Government has increased focus on DC governance and value for money. However, DC lacks some of the characteristics of DB that can contribute to higher returns.

Effective implementation of the Government's new Value for Money initiative

At the start of 2023, the pensions minister, Laura Trott, announced a package of measures intended to reform the private pensions industry to ensure that pensions are "fairer, more predictable, and better-run". She stated that "driving a long-term focus on value for money across the pensions sector is a key priority for this Government."

The package included a consultation on new requirements for all DC pension schemes to disclose their performance on investment returns, costs and charges and quality of service, and would provide transparent comparisons between pension schemes. The aim was to improve the availability and transparency of consistent information and data on these key factors to enable schemes, employers and members to understand the performance and quality of their pension scheme, with the objective of improving the overall value for money they provide and driving competition across the market.

These factors are recognised by regulators and they are working together to progress the practical implementation of the Value for Money initiative. The timing of this is still to be decided with further consultation by the FCA in Spring 2024 following earlier joint papers with the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR).

There are a number of themes emerging (perhaps reflecting the various preferences of the three bodies) including the use of metrics, a focus on fees and charges and a focus on backward looking and forward looking performance metrics, along with potential consequences similar to the approach in place in Australia.

Successful implementation of a well designed Value for Money framework will be an important component in providing the necessary information to enable more informed decisions to be made on DC pension saving.

Existing DC pension schemes provide a pot at retirement rather than an income for life

Defined benefit schemes provided a pension for life to pension members (i.e. a stream of payments starting at retirement date (e.g. age 65) and ending upon death of the pension member's beneficiary). This meant that the effective term of the investment for funds invested to provide the pension payments could be as long as 70 years from the point of investment. For example, contributions which start to be paid in respect of a pension member on their 20th birthday would be required to produce pension payments through to the death of the beneficiary who may live into their nineties.

In addition, as well as the long investment time horizon, defined benefit schemes pooled their assets across all pension members which meant that contributions paid in respect of younger pension members could be used for the scheme's liquidity requirements rather than being forced to disinvest invested assets at specific times. Defined contribution schemes have neither of these characteristics (i.e. by design and regulation (which was partially relaxed in 2015)) and members' pensions were broken into two distinct phases of accumulation and decumulation (accumulation meaning the savings period and decumulation meaning the period during which the pension was drawn). At the transition point (the pension members' "retirement date") the accumulated funds would need to be liquid so that the pension member could withdraw up to 25% as a lump sum, buy an annuity with the remainder (or since 2015 positively opt for an income drawdown solution) or to consolidate with other pension savings.

DC investment in Private Capital - issues and challenges

The use of default funds, the lack of investment and risk pooling and a need for liquidity at the point of retirement, can reduce the time horizon for asset returns. CDC schemes have been discussed as a potential way of solving these challenges.

This characteristic effectively meant that the pension member was building up a retirement savings pot which the scheme would need to make liquid at the pension member's retirement date and so effectively reducing the investment time horizon significantly compared to a defined benefit scheme. In addition, in a DC pension scheme from a pension member's perspective there is no pooling with other pension members' investments or contributions and so each individual pension member's investment option needs to provide the full liquidity requirement at the pension member's retirement date (e.g. the member can act entirely unilaterally without regard for the behaviour or strategy of others and hence needs to take full account of the risk of their own strategy (that is not to say that some of their investments are not 'pooled' in the same investment, e.g. a particular fund for example)). These two characteristics (i.e. schemes providing a retirement savings pot rather than a pension for life and lack of ability to pool investments) reduces the flexibility significantly for investing in illiquid assets due to the much shorter investment horizon and the inability for the pension member to individually manage their liquidity risk.

The effect is further exacerbated by the fact that the majority of pension members are automatically placed into the DC pension scheme's default investment option. This would have an automatic transition to predominantly cash/fixed income type liquid assets (commonly referred to as "life styling") which in lots of cases results in a transition starting ten years prior to the pension member's estimated retirement date into predominantly cash/fixed income type liquid assets.

Members also expect to be able to move their pension between providers on request prior to and following their retirement date and they have a statutory right to do so. In order for providers to do this, it requires a level of liquidity.

The Government has recently introduced the enabling regulatory framework for a new type of pension wrapper called a Collective Defined Contribution Scheme (CDC). A CDC scheme has characteristics much closer to a defined benefit scheme and is designed specifically to enable pooling of investments and the provision of long-term pensions rather than a pot at retirement. CDC schemes may therefore have a greater capacity to invest in Private Capital as a result of the longer term investment horizon and more flexibility to manage their own liquidity requirements compared to an individual member in a defined contribution scheme.

To date there is only one CDC scheme that has progressed to advanced stages of establishment but this is not yet in operation.

Specific investment options made available by Master Trusts consistent with their wider ESG/social purpose objectives

In the area of workplace DC pension schemes (as opposed to individual personal pensions and SIPPs), to date the pension member typically has no choice over the provider (a specific Master Trust or Group Personal Pension is typically procured by the employer) and the pension member's choices are then presented as a limited range of investment options selected by the Master Trust/GPP provider (sometimes with input/consultation with the employer). Therefore, to date, demand for specific investment options (including Private Capital) is not just influenced by individual saver demand but is also a function of the specific objectives of the Master Trust/GPP.

These objectives will balance a range of factors including making investment options available with a range of risk, return and cost criteria, and, in recent years, has also included an ESG component. As Master Trusts grow and their asset bases become more significant, the impact of their buying power on local economies, sectors and asset classes will become more material and, therefore, their desire to bias more towards investment in UK and productive finance type assets compared to non-UK is likely to be influenced by the specific blend of their ESG objectives. Indeed, investment in Private Capital can make it easier to demonstrate a 'real world' ESG impact where the underlying asset is more identifiable.

DC investment in Private Capital - issues and challenges

The City of London Corporation estimates that only 0.5% of UK DC assets are invested in unlisted equities. This is partly a consequence of the use of life platforms which have complexities and restrictions.

Investment options made available by pension providers

Workplace DC pensions are typically delivered by employers through one of two routes. Either they procure a pension trust (historically they would set up their own individual trust and appoint their own trustees to operate the trust, but market practice has moved to employers taking a section in an already established Master Trust with existing trustees and infrastructure) or procure a pension product from an insurance company called a group personal pension (GPP) where their employees would then contract directly with the insurance company for their pension provision.

The experience to date is that whichever route has been taken there are comparatively low levels of Private Capital offered to pension members of these DC pension schemes (when compared to the choices made available by large, well established DC pension schemes in other economies with a well regarded pensions system e.g. Australia, Canada and the Netherlands).

While this may be a result of a lack of ‘consumer’ demand (as set out on the previous pages) there may be other issues which are contributing to the relatively low levels of investment options for Private Capital in UK pension schemes, as follows.

Some of the issues which may have contributed to (or may influence in the future) the lack of availability of Private Capital by pension providers

Prevalence of life platforms

The operational aspects of DC pension schemes are complex and require sourcing and managing of investments, allocating an appropriate investment return to an individual pension member’s savings pot and ensuring that appropriate governance and controls are in place. This is more complicated for a DC pension scheme than a defined benefit scheme given the potential need for individual pension members to have (for example) daily information on their retirement pots, investment performance and the ability to make and implement decisions on investment options. This infrastructure largely results in a relatively high fixed cost which means that when DC pension schemes are smaller the fixed costs become significant on a per pension member basis.

Historically, each employer has set-up their own DC pension scheme and so in order to practically implement the pension scheme on a cost-effective basis they would use a bundled solution from a life insurance company (called a life platform). This would either be the employer setting up a trust with its own trustees and then the trustees procuring a life platform to provide the services, or the employer procuring a life platform directly in the form of a GPP.

This bundled approach could be considered to work well from a cost-benefit perspective where DC pension schemes are smaller, however, it also has some intrinsic complexities which could be limiting the provision of Private Capital options.

If a trust is used to provide pension benefits, it is regulated by the Pensions Regulator and is governed by a general trust law and fiduciary duty on the pension scheme trustees. This means that there is significant flexibility over many aspects including the investment options that can be made available. In contrast, if a life platform is used, it is subject to regulation by the FCA and the specific requirements of retail investment products, which are designed to protect retail customers.

We note that Life platforms have their own commercial imperatives (for example cost of capital for investment in systems which can accommodate non-daily pricing) and competitive pressures which may not align perfectly with trustees' or members' interests or desire for innovation.

DC investment in Private Capital - issues and challenges

The increasing scale of Master Trusts combined with market consolidation could enable the development of bespoke and flexible infrastructure; maximisation of the benefits could require actions from members.

Therefore, historically whichever route an employer has chosen (i.e. trust or group personal pension) the net effect has been the use of retail financial products (via life platforms) for the provision of pension benefits (effectively imposing potential complications as result of dual regulatory environments when a trust is used as well as potentially reducing a trust's flexibility on its investment options).

Some of the additional complexities as a result of the use of life platforms are: some restrictions on unlisted and illiquid assets (as a result of the FCA permitted links requirements); potentially reduced control for the trustees in relation to the underlying investments which may not be in line with a Master Trust's ESG requirements; and potentially additional cost layers compared to an unbundled solution.

In view of the complexities of including Private Capital in retail financial products, the FCA introduced a new investment wrapper called a Long Term Asset Fund ("LTAF") in 2021. To date we understand that take-up of this approach has been low, however we understand that interest in this structure has accelerated since the Mansion House Compact.

Degree of consolidation of the DC pension scheme market (and the additional complexities of GPPs)

The Government's ambition (in conjunction with enabling legislation, including the Value for Money initiative) is for the UK DC pension scheme market to consolidate into a smaller number of larger pension providers (including Master Trusts catering for multiple employers as opposed to the historical approach of each employer setting up their own pension provision). The objective is to improve pensions for pension savers through higher standards, higher returns and lower costs including greater investment in Private Capital. The scale will also improve the scheme's ability to manage liquidity issues due to the size of the monthly inflow of contributions.

As set-out above, one of the benefits of scale will be that Master Trusts can establish their own infrastructure (sometimes referred to as a custodian platform approach rather than using a bundled solution from a life insurance company). This has the potential to increase investment flexibility, reduce costs (at scale) and increase the Master Trust's ability to tailor the pension provision to 'consumer' demands (we note that a number of Master Trusts are also insurance providers with a GPP product which when looked at together already produce scale).

While the GPP market has consolidated at provider level, one potential issue which could reduce the consolidation benefits for pension members is the difficulties in consolidating GPP policies. This is because in GPPs, the employee has their own contract with the pension provider and as a result of the historical use of GPPs for pension provision, many employees may have a number of small GPP policies with different providers resulting from their previous periods of employment. Consolidation of these individual policies requires an active decision on behalf of the pension member/policyholder which is therefore more complicated than pensions provided by a trust where trustees can consolidate historical pensions on behalf of the pension member. Therefore, in the future there is the potential for pension members with multiple historical GPP type products to not have easy access to the benefits of consolidation (including access to unlisted investment options) unless they take specific action themselves (in the absence of an alternative solution to multiple / 'small pots').

Fees vs performance

DC pension schemes are typically procured by employers and it could be argued that the procurement process has focussed on fees (rather than performance net of fees) offered by pension providers. This has potentially resulted in providers biasing their investment choices to those with lower costs. Private Capital would typically be expected to be more expensive from an investment management perspective with the general expectation that the additional costs would be more

DC investment in Private Capital - issues and challenges

A shift in focus from costs to net performance, as well as improvements in governance and transparency, could increase member understanding and drive engagement.

If there is to be a greater offering of Private Capital to pension scheme members in the future then it will require a greater degree of sophistication on the procurement side in order to recognise higher cost for access to potentially higher returning options. In addition, it will also require new ways of engaging with members so that they understand the potential for greater returns with higher costs.

Since auto-enrolment in 2012, the Bank of England has embarked on a significant quantitative easing initiative which had the general effect of raising asset prices over that period. As we look forward over the next ten years the economy faces a potentially higher inflationary, lower growth environment than the previous ten years and so the need for more sophisticated (and potentially more expensive) investment options will be more critical for the outcomes of pension savers.

The pension providers will therefore need to adapt to a new environment of competition on performance net of fees (rather than just fees)[1] and the additional transparency of the Value for Money framework will further incentivise this new approach.

Potential Solvency II implications

Investments offered to DC pension scheme members via life platforms are subject to insurance companies' Solvency II requirements. To date there are low percentages of Private Capital on life platforms for DC pension scheme members but if this were to increase significantly in the future then there may be additional obligations in relation to the requirements of Solvency II as a result of the increased scale. For example, insurance companies need to have additional active liquidity management processes because they need to ensure that unit fund liquidity is in place so that policyholders are not unfairly disadvantaged as a result of the forced sale of assets.

Insurance companies are also subject to customer fairness/Consumer Duty requirements so if greater access to Private Capital in unit funds is available there could be the need for additional advice on behalf of the policyholder before investing (although we note that the IGCs already have responsibilities for acting in the members' interests and for considering these issues). Finally, while there is no specific additional capital requirement, significant levels of Private Capital in unit funds could produce different economic stresses into the capital calculations for unit linked products, requiring amendment to general capital buffers.

Investment trusts

One of the potential options for DC pension scheme members to have access to investment in productive finance is via listed investment trusts. However, currently there is some uncertainty over the regulatory requirements in relation to their cost disclosures including parliamentary debate. If this approach is to be a successful component of the Government's ambition of attracting DC pension scheme investment into UK Private Capital then the status of investment trusts in particular in relation to disclosure of costs will need to be clarified as soon as possible especially given the anticipated benchmarking that will be required under the Government's Value for Money initiative.

1 - This will also need to take into account the fair approach to performance fees taking into account the timing of the assessment of performance and members joining or leaving the scheme / fund.

Investment structures

Defined contribution structures

Private capital

Existing structures

Emerging structures

04

Overview of the structures reviewed

We have set out below a list of the key structures reviewed in this report. We have focussed on those structures that are most commonly used and so this does not represent a comprehensive list and there will be variations to many of the structures set out below. Further detail on each of these structures is set out from pages 32 onwards, including an overview of the key characteristics of each structure, how the are currently used and key considerations for the pensions and Private Capital markets.

Wrappers	Example structures
Pension wrappers (see page 16)	**Contract products *** DC Group Personal Pension (GPP) Plan **Trust based pensions** DC Master Trust Collective defined contribution schemes (CDC)
Life platform	Life platforms Custody platform/Direct investment
Fund of funds (pension examples in italics)	Limited Partnership Fund of Funds Pooled Funds (e.g. similar to structures that some LGPSs have put in place) Australian example - IFM Investors
Fund	Limited Partnership Fund (LPF) Semi open ended Private Capital fund Long Term Asset Fund (LTAF) European Long Term Investment fund (ELTIF) Perpetual capital/investment funds
Underlying investments	Co-investment Separate Managed Account (SMA)

*Individual pensions and SIPP excluded

Note to reader - this diagram is an illustration. It includes and does not seek to distinguish between the following (1) certain economic arrangements (e.g. fund-of-funds structures, pension fund pooling arrangements, co-investment); (2) commercial features (e.g. open-ended versus closed-end versus semi-closed end structures); (3) legal forms (e.g. limited partnerships, trusts, companies, true separately managed accounts); (4) regulatory wrappers (e.g. ELTIFs, LTAFs, QIS, QAIF), and (5) specific examples (e.g. IFM Investors).

Key considerations for structures

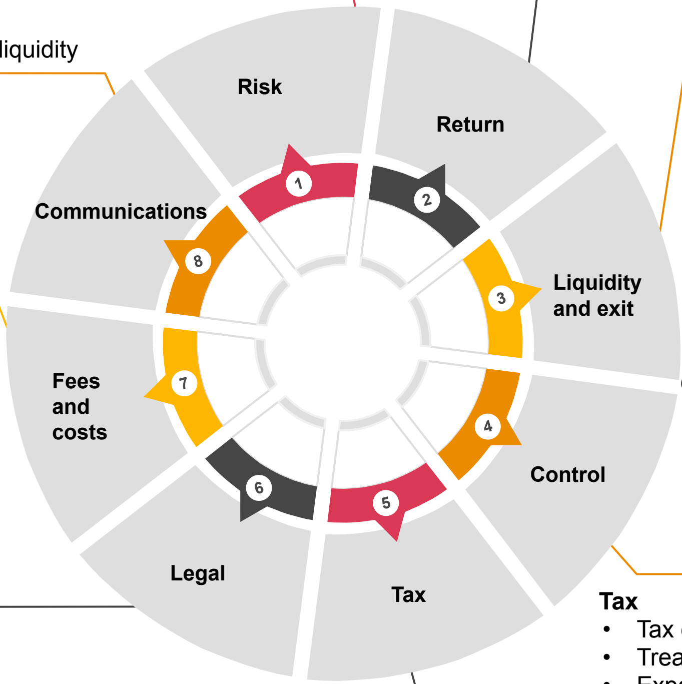
For the wrappers and structures on the previous page, in the following sections we comment on each of the assessment factors below which are the key factors that stakeholders ordinarily consider when determining whether to utilise a particular structure.

Risk
- Regularity of distributions
- Whether illiquid nature of assets gives rise to inability or restrictions on withdrawing capital.
- Newer structures offer limited track record/data to accurately measure risk.
- Risk mitigation factors;
  - A diversified portfolio
  - Private capital firm track record
  - Robust due diligence
  - A compelling investment strategy
  - Secondaries market (or open-ended structure) for liquidity

Communications
- The extent that investors, and their members (in the case of pensions) feel informed and empowered.
- Regulated and legal status of the investment dictate different communication frameworks, but the investor may also have their own requirements.

Fees and costs
- Key considerations will include,
  - Fees for fund manager (or equivalent) which can be both fixed and performance based (NAV-based performance fees, profit share/carried interest)
  - Costs of transactions or other legal services.
  - Extent of additional monitoring or compliance costs that might be borne by the investor
  - Value of outsourced versus in-house resource.

Legal
- Cost implication of regulatory framework
- Due diligence on products and investments
- Investor limited liability or exposure
- Flexibility regarding product design (fund terms)



Return
- Measured through:
  - Cash flows
  - Exit proceeds
  - Ongoing valuation/NAV
- Returns/performance metrics
- Risk adjustment
- Valuations: methodology and reporting frequency

Liquidity
- Consideration of options for liquidity solutions (e.g. liquidity buffer, redemption rights) where liquidity cannot be managed at scheme level
- Costs, returns and operational implications of open-ended or semi-open ended structures
- Avoiding liquidity mismatch (between assets, expectations and product terms)
- Fixed or flexible exit strategy and consensus with other stakeholders

Control and operations
- Governance and investor control/participation in decision making
- Influence of investors and fund manager
- Strength of relationships with co-investors/fund members
- Drawdown model versus up-front investment
- Ensuring fairness between members for carried interest or performance fees

Tax
- Tax efficiency
- Treatment of gains and losses
- Exposure to tax risks; double taxation, withholding tax, transfer pricing, anti-avoidance, or tax audits.
- Complexity and clarity of the tax laws by jurisdiction

Defined Contribution structures

05

DC contract based Scheme - Group Personal Pension

GPPs, commonly provided by insurers, often use a life platform that can restrict the range of investments. Some market estimates suggest a reduction in the use of GPPs over time as these can have higher cost than Master Trusts.

Description of the structure

- Workplace pension offerings, often provided by insurers.
- Regulated by the FCA and overseen by an IGC (see below).
- Contract-based pensions are included in Solvency II calculations that must be provided to the Prudential Regulatory Authority (PRA).

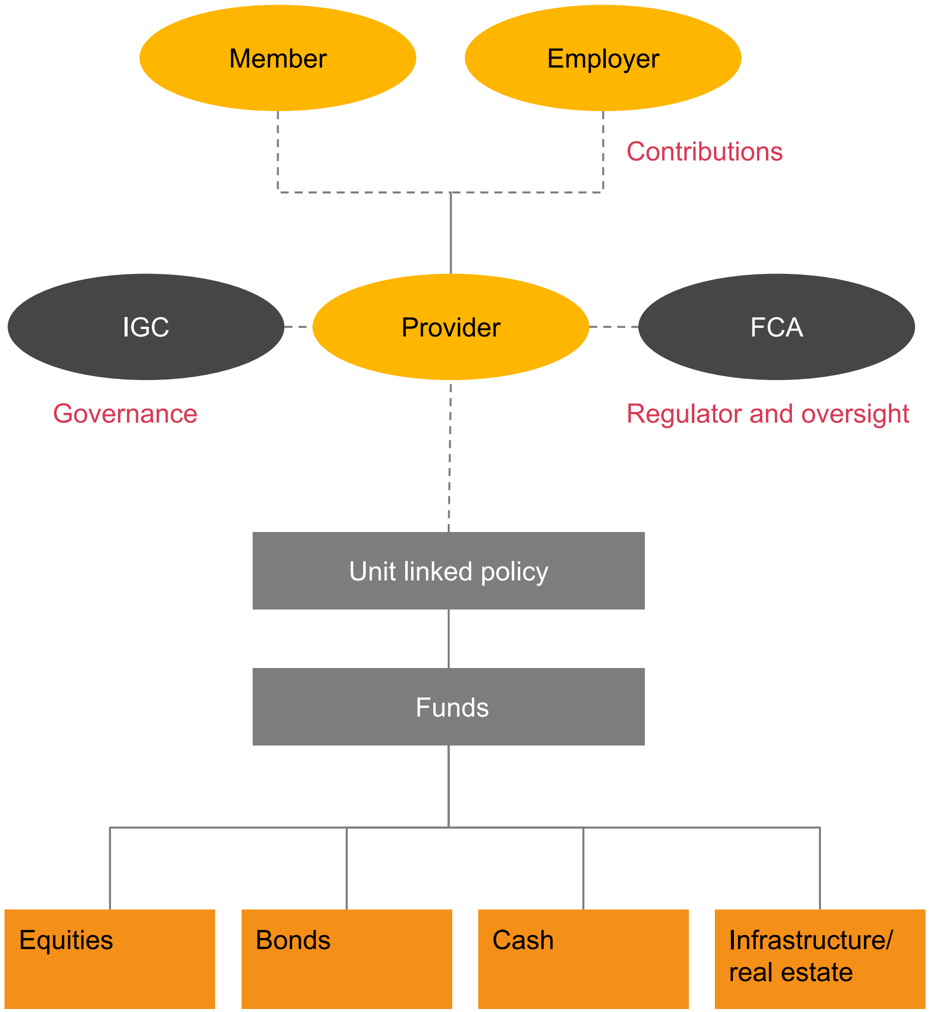
Current use

- Commonly used by medium and large employers for the pension provision of employees. Albeit the growth of Master Trusts is slowing the use of these types of pension schemes.

Key observations

- FCA rules require firms that operate workplace personal pension schemes to establish and maintain Independent Governance Committees (IGCs) and be FCA regulated.
- FCA regulated firms will fall under the Consumer Duty rules.
- IGCs have a duty to scrutinise the value for money of the provider's workplace personal pension schemes, taking into account transaction costs, raising concerns and making recommendations to the provider's board as appropriate. IGCs must:
  - act solely in the interests of relevant scheme members
  - act independently of the provider
- The IGC oversees the providers when deciding on the fund range available to members.
- It is key that IGCs have the right qualifications, skills and experience to fulfil their role on behalf of the scheme members.
- Charges are limited by the charge cap. We note that from April 2023, there is an option for trustees managers to enter into investment arrangements that include performance-based fees that are exempt from the charge cap calculations.
- GPPs operate in a competitive market where commercial success drives innovation. The key focus of competition are commonly factors such as: price, technology offering, personalised communication, enhanced retirement offerings and financial wellbeing services.

Illustration of the structure



DC Master Trust

DC Master Trusts have grown substantially over the last 10 years and the larger Master Trusts now have the scale to invest in a broader range of investment structures (including direct investment).

Description of the structure

- Single trust structure. A Master Trust is a bundled provision with service providers overseen and operated via the Master Trust.
- Authorised, overseen and monitored by The Pensions Regulator.
- Master Trusts can be set up for a specific member population or limited to specific industries (although these are an increasingly small part of the market).
- Trust based Schemes are not subject to Solvency II.

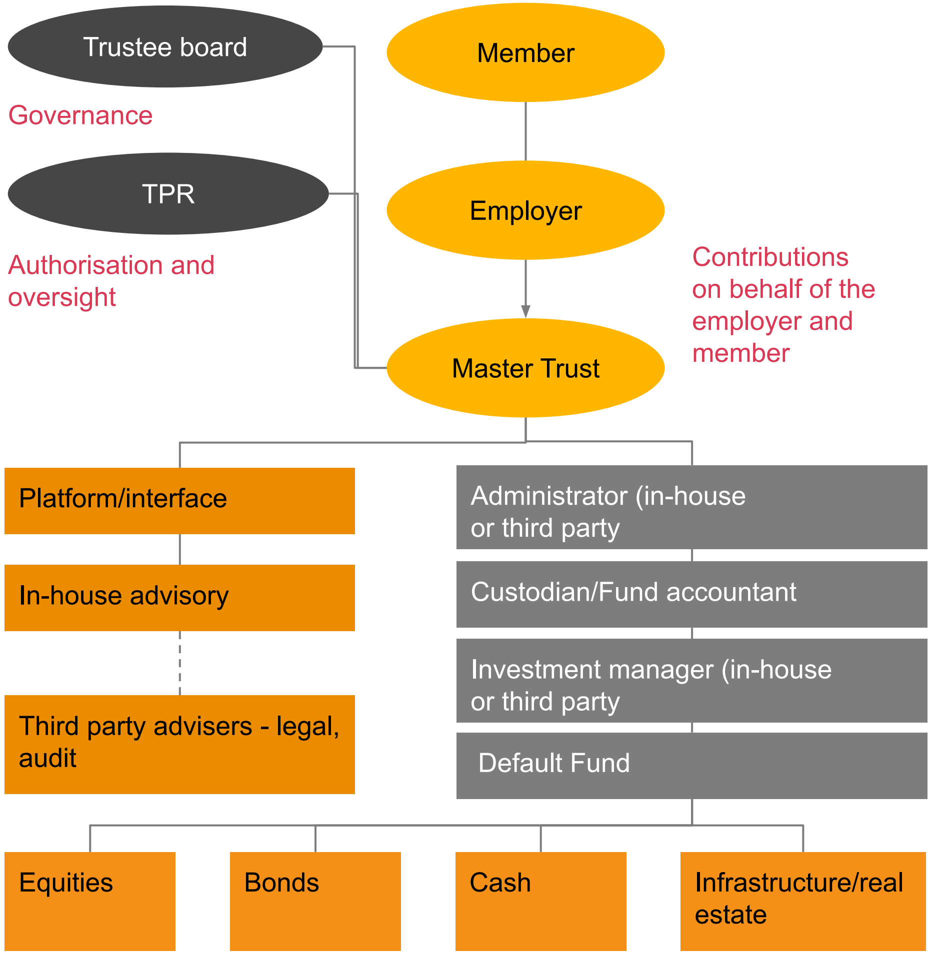
Current use

- Commonly used for auto-enrolment and as a result have a default fund. c.94% of members invest in the default fund[1].
- A number of Master Trusts are operated by insurers who also have a GPP product.
- 31 Master Trusts. c.24 million members, average pot size c.£6,000+[2].
- AuM currently estimated to be c.£105bn projected to grow to c.£400bn by 2030

Key observations

- Independent trustee board, regulated and with fiduciary duties and executive powers under the Pensions Act.
- The Trustees, supported by in-house or third party investment advisers, decide on the fund range available to members, and are required to monitor and perform governance reviews on the funds that are offered. As a result the range of funds can be smaller compared to a contract-based pension.
- Similar to IGCs for contract based schemes it is key that trustees have the right qualifications, skills and experience to fulfil their role on behalf of the members.
- Value for money assessment reported to The Pensions Regulator via the chair's statement annually and made publicly available
- Charges are limited by the charge cap (at 0.75% of assets under management). We note that from April 2023, there is an option for trustees' managers to enter into investment arrangements that include performance-based fees that are exempt from the charge cap calculations.
- Operate in a competitive market - commercial success drives innovation. Key focus of competition is price, and increasingly technology offering, personalised communication, enhanced retirement offerings and financial wellbeing services. Some providers are also developing new decumulation option for members.

Illustration of the structure



1 - https://assets.publishing.service.gov.uk/media/6575970958fa30000db141c5/evolving-the-regulatory-approach-to-master-trusts.pdf
2 - https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2022-2023 - note this relates to average assets per membership in occupational DC schemes (excluding hybrid schemes) for 2023, of which Master Trust members are the majority.

Group Personal Pension and Master Trust - considerations

Potential advantages and limitations across each of the key consideration categories

	GPP	Master Trust
Risk	• Level of risk can be managed through a diversified portfolio. The suitability of the investments offered is monitored by the IGC. • Ultimately the level of risk is determined by the member and their choice of funds, however most members are in a default fund. • Members may be guided to a de-risked asset strategy as they reach retirement age.	• Consistent with GPP, noting that the vast majority of members are in the default fund so the level of risk is consistent across all members. • Required to hold capital to manage downside scenarios promotes confidence in their longevity and security, although this may result in an opportunity cost of capital that could be invested in innovation. • Members may be guided to a de-risked asset strategy as they reach retirement age.
Return	• Investment return is determined by the performance of the funds chosen by the member. • Members will receive little support in choosing investments and many members stay in the default fund. • With the vast majority of members default fund GPPs can compete on the performance of their default fund. • Many GPPs can access in-house specialists and market connections.	• Consistent with GPPs
Liquidity and exit	• Investments are typically liquid or can be liquidated at short notice as the are invested in large retail funds with a number of regular buyers and sellers. • The majority of these funds are invested in listed equities.	• Consistent with GPPs
Control	• Member has control of contributions and investments. The member has no influence over the performance of their investments. • Range of investments and value for money is overseen by the IGC. Platforms are starting to provide members with greater choice of funds in certain sectors or with certain characteristics (e.g. ESG focussed funds). • Default funds and other options (self-select) offer illiquid investments from property to private credit, infrastructure. Some providers offer more active investments in their non-default funds (e.g. for self-select savers).	• Members do not have access to sophisticated advice or information, majority of members continue to be invested in the default fund. • As relatively new vehicles Master Trusts may have the flexibility to adapt to new markets and products. • Range of investments is similar to GPPs.

Group Personal Pension and Master Trust - considerations

Potential advantages and limitations across each of the key consideration categories

	GPP	Master Trust
Tax	• From the member's perspective the pension is sheltered by a tax wrapper and, ordinarily, only incurs tax at the point of drawing the pension.	• Taxes taken into account through the underlying assets comprising the value of the fund invested in by the member. From the member's perspective the pension is sheltered by a tax wrapper and, the majority of members only incur tax at the point of drawing the pension.
Legal and regulation	• Well established governance structures with regulatory oversight from the FCA. • GPPs have been widely used in the market for a considerable period of time and are well understood by employers and to some extent, members.	• Regulated by The Pensions Regulator. • The larger Master Trusts are experienced in managing regulators and regulation.
Fees and costs	• PPI analysis estimates that total expense ratios in GPPs are often around 1%[1]. • Costs are dependent on the funds chosen by the member and the employer.	• PPI analysis estimates that total expense ratios are around 0.5%[1] and tend to be lower than other DC workplace pensions, due to Master Trust schemes being specifically designed with economies of scale in mind and competing primarily on cost. • Master Trusts are also more likely to use lower-cost funds and asset classes relative to single-employer trust-based schemes.
Communications	• Opportunity to increase member engagement through use of new technology platforms and upcoming Pensions Dashboards.	• Some employers are opting to switch to Master Trust providers as they are able to offer members a better technology platform and back office support compared to that provided by contract based schemes. • Ease of member switching means that maintaining a strong brand and reputation is key.

1 - https://www.pensionspolicyinstitute.org.uk/media/xfybvxtq/20230926-the-dc-future-book-9-2023.pdf

Collective Defined Contribution (CDC) Schemes

A new pensions arrangement where risk is pooled across the member population - however, only one CDC has been approved to date by TPR and that scheme is not yet operational.

Description of the structure

- A CDC scheme aims to provide a target level of income in retirement for its members, based on the pooled contributions and investment returns of the scheme.
- A CDC scheme does not guarantee any particular level of benefits and there could be adjustments made to the targeted level of benefits depending on the funding and performance of the investments.
- However, given the pooling of risk across different generations, the expectation is that adjustments to the benefits will be less material when compared to individuals holding separate DC pots.
- CDC schemes can be ‘whole of life’ or ‘decumulation only’. A whole of life scheme operates over the course of an individual's pension savings journey, e.g. over both accumulation and decumulation. This provides a longer time horizon and as a result potentially more predictable benefits. In a decumulation only scheme the time horizon is shorter and as a result a more prudent investment strategy may be required to match to the risk profile of its members.
- The legislation does not currently permit multi-employer CDC schemes or decumulation only schemes, but the Government has stated an intention to amend the legislation to permit multi-employer schemes in 2024 and to allow ‘decumulation only’ schemes in the future.
- Plans with similar characteristics have been widely used in a number of other countries (e.g. the Netherlands and Canada).

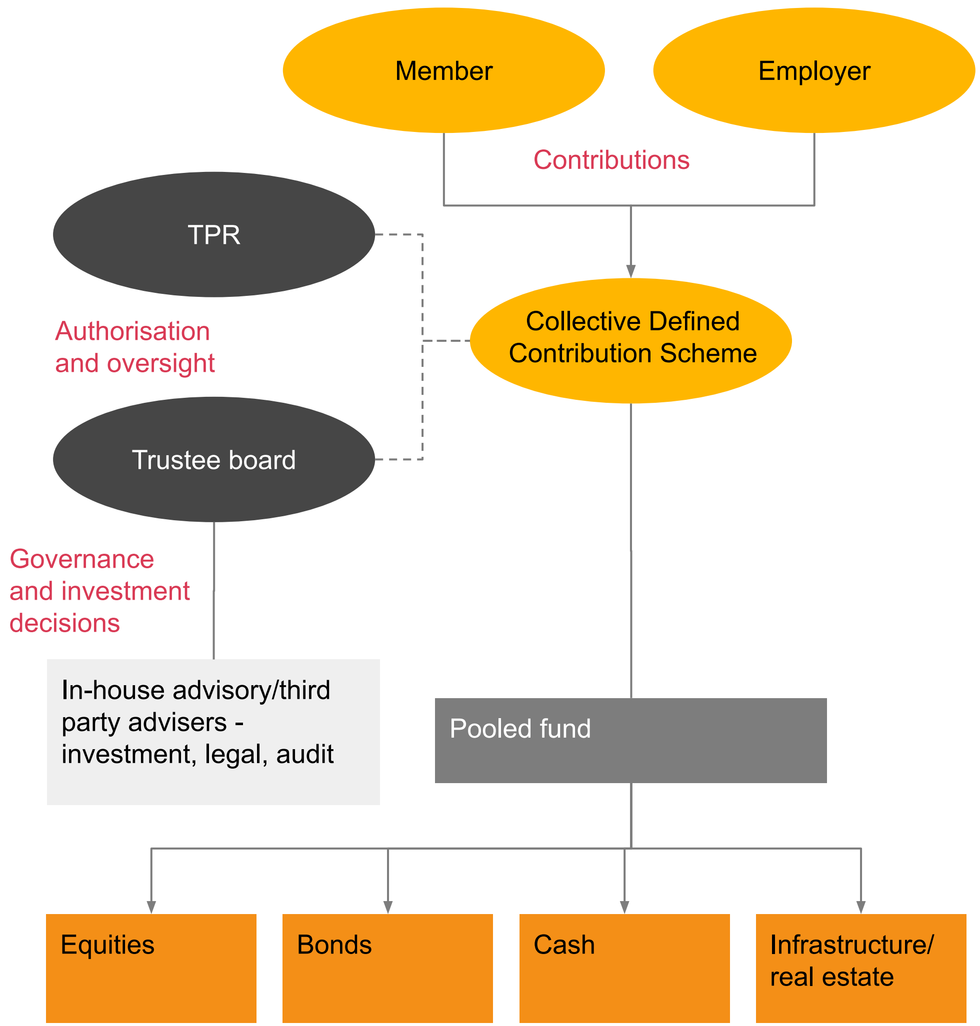
Current use

- The Pensions Scheme Act 2021 provided the legislative framework for CDCs. CDCs are not yet widely used in the UK and they need to be authorised by the Pensions Regulator. To date, only one CDC Scheme has been authorised - The Royal Mail Collective Pension Plan.

Key observations

- Investment decisions are not generally made by members, instead the scheme trustees make the investment decisions. In order to make the pooling work effectively for CDC schemes, there will be a need for:
  - schemes to achieve scale in terms of number of members and assets under management (not suitable for smaller schemes); and
  - an expectation that a CDC scheme will be in place over a long period of time.

Illustration of the structure



Pooled funds

A pooled pension fund is a form of "fund of funds" which makes investments on behalf of a number of separate pension schemes to take advantage of scale to leverage higher returns at lower cost.

Description of the structure

- Pooled funds are a type of investment vehicle that allows multiple pension schemes to pool their assets and invest in a diversified portfolio, such as equities, bonds, property, or alternative assets.
- Assets and investments of pension funds are managed – or "pooled" – on a collective basis. The investors share the benefits and risks of the pooled fund according to their proportion of the total assets.

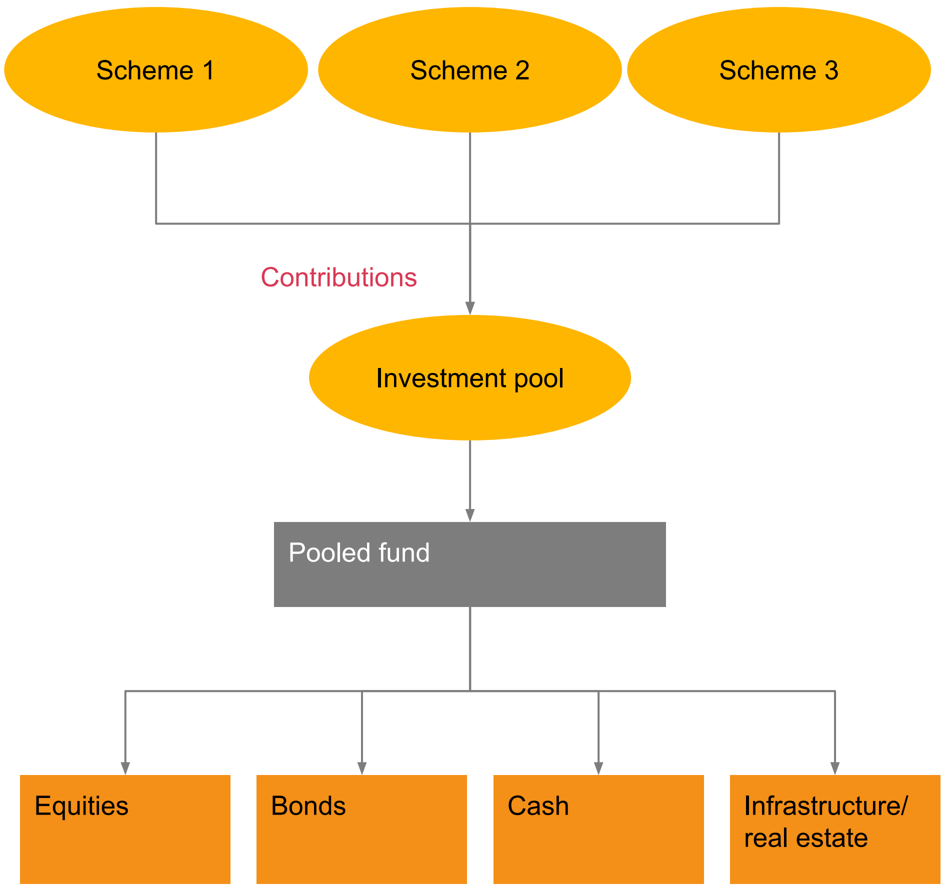
Current use

- An example of this is the UK Local Government Pension Scheme (LGPS - note this is a Defined Benefit fund, not a DC fund but is referenced here as an example of the use of pooling in the UK), which has 86 pension funds and has eight investment pools to invest on their behalf. As at March 2022 these pools represented £145bn of assets, with individual pools ranging in size from £16bn to £60bn.
- The scale of the funds, purchasing power and their long time horizon enables the hold of illiquid assets as well as the opportunity to take into account a wide range of criteria and ESG factors. In 2021-22 the LGPS had c. 4.3% investment allocation into private equity. The Government has indicated an objective of increasing this to 10%.

Key observations

- Pooled funds can benefit from the professional skills, research, and experience of the fund manager, who can monitor the market conditions, select the best securities, and adjust the portfolio accordingly. This can be provided externally or there is the potential to grow in-house investment management which may reduce cost further.
- Pooled funds can reduce the costs of investing, such as transaction fees, administration, custody, and auditing, by spreading them across a larger pool of assets and investors and achieving cost savings through economies of scale.
- Pooled funds can provide access to a wider range of asset classes, markets, sectors, and strategies than individual investors could achieve on their own, which can reduce the overall risk and volatility of the portfolio.
- Pooled funds can simplify the investment process for pension schemes, as they do not have to deal with the complexities of selecting, buying, selling, and holding individual securities, or complying with the regulatory and reporting requirements.
- Effective and consistent governance and decision making is a key priority for pooling of funds due to their scale and responsibility to multiple schemes and members.

Illustration of the structure



1-https://www.gov.uk/government/consultations/local-government-pension-scheme-england-and-wales-next-steps-on-investments/local-government-pension-scheme-england-and-wales-next-steps-on-investments

CDC and Pooled funds - considerations

Potential advantages and limitations across each of the key consideration categories

	CDC	Pooled Funds
Risk	• Level of risk is managed through having a diversified portfolio and the pooling of risk across different generations of member. • CDC can provide more stable and predictable retirement incomes than individual defined contribution (DC) schemes. • However there are no guarantees provided by the employer, consequently, there is a risk that benefits could be lowered.	• Level of risk is managed through a diversified portfolio.
Return	• Investment return is determined by the performance of the funds chosen by the Trustees and the target rate of return. • Potential for higher returns over the long term to be achieved as trustees can invest in higher growth illiquid assets due to the longevity of the structure and the pooling of risk. • CDC is designed to provide an income for life (adjusted as required) and so avoids the risk of a member running out of money (as applies in DC decumulation).	• Allows pension schemes to diversify their investments across different asset classes, regions and sectors as well as offer access to alternative and illiquid assets. This may otherwise be inaccessible or too costly for individual schemes.
Liquidity and exit	• With scale and a constant influx of leavers and joiners liquidity should be able to be managed across the Scheme.	• There may be limited redemption options depending on the strategy of the fund. Reliance on estimates may affect the accuracy and timeliness of the portfolio reporting.
Control	• Trustees have the flexibility to invest in a broader range of investments and Trustees make investment decisions rather than members.	• Delegation of investment decisions and oversight to fund manager • Less flexibility and control following the fund mandate and rules, which may not align with the pension scheme's preference.
Tax	• Taxes taken into account through the underlying assets comprising the value of the fund invested in by the member. From the member's perspective the pension is sheltered by a tax wrapper and only incurs tax at the point of drawing the pension.	• Taxes taken into account through the underlying assets comprising the value of the fund invested in by the member. From the member's perspective the pension is sheltered by a tax wrapper and, ordinarily, only incurs tax at the point of drawing the pension.

CDC and Pooled funds - considerations

Potential advantages and limitations across each of the key consideration categories

	CDC	Pooled funds
Legal and regulation	• Regulated by the Pensions Regulator. • CDC Schemes are a relatively new concept with only one scheme authorised by The Pensions Regulator to date. However, there is scope for more widespread use for employers and Master Trusts that have a large member base.	• Pooled funds may face increased regulation and scrutiny from TPR, or FCA which may increase the costs and complexity of the fund's operations. • Underperformance of fund, mismanagement or scandals may damage the fund's credibility and expose the fund and pension scheme to lawsuits, fines, etc.
Fees and costs	• If scale can be achieved on CDCs then the cost of running the scheme should come down as savings are made as a result of lower administrative and governance costs, and as a result of more efficient asset allocation and risk management strategies. • Due to there being no active CDC schemes the ongoing costs of a CDC arrangement are not yet known.The benefit of scale will need to be balanced with the requirements for annual valuations and an appropriate mechanism to adjust benefits. • Whilst some of the larger Master Trusts now have the scale to launch a CDC scheme should they wish to do so this may require some additional investment to set up the infrastructure.	• Can benefit from economies of scale, lower transaction costs and better bargaining power. • Pooled funds can facilitate the consolidation of smaller and underfunded pensions schemes that may seek to pool their assets and liabilities to achieve greater scale, efficiency, outcomes and security of pension members.
Communications	• These are relatively new structures and so not widely understood by members. • CDCs may require more focus on communications with members due to the potential cuts to target returns. • The complexity of the arrangement may put off some members from joining a CDC scheme.	• Pooled funds can benefit from the innovation and development of new products e.g. ESG funds, smart beta funds that may offer better risk-adjusted returns.

Australian pension arrangements example - IFM Investors

IFM investors is a fund manager owned by a number of pension funds with the aim of pooling funds to maximise economies of scale, reducing costs, and enabling long-term investment in a range of diversified and illiquid assets.

Description of the structure

- A central feature of the Australian pension landscape is the superannuation system, a pension arrangement similar to a trust-based UK DC scheme.
- IFM is a global fund manager (it is not a superannuation fund) owned by 17 Australian superannuation pension funds, investing in infrastructure, debt, and private equity to deliver long-term returns and social benefits for members.

Current use

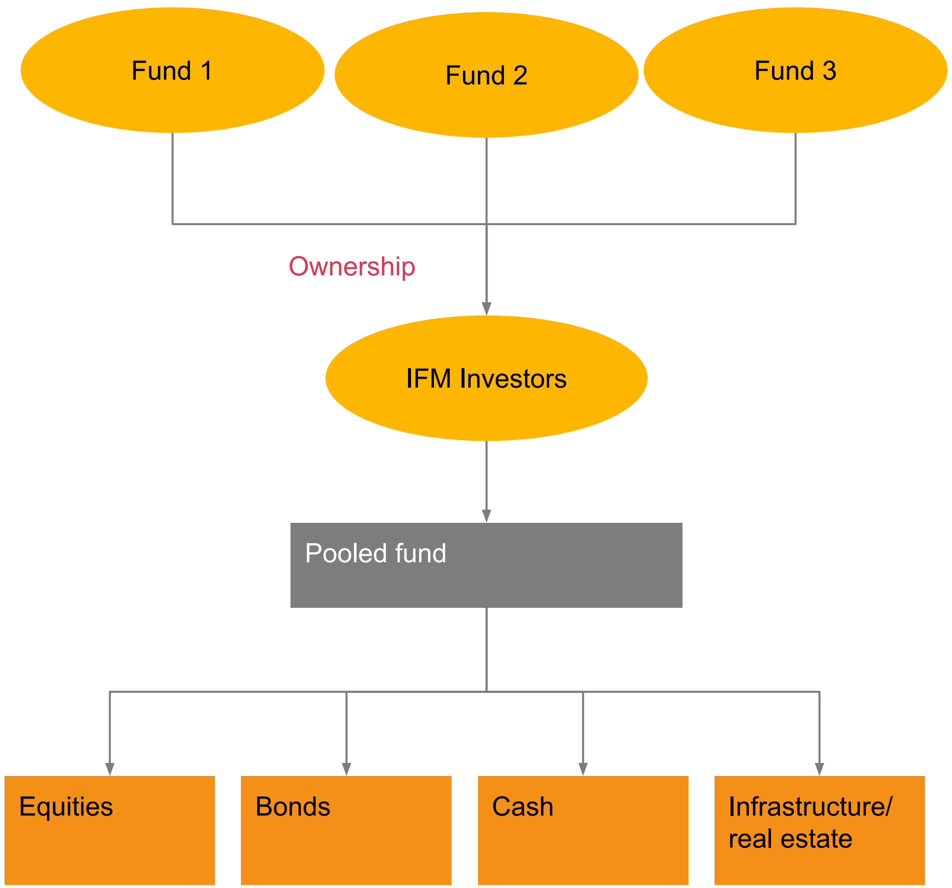
- IFM has c.£100bn invested on behalf of 625 institutional investors at 30 June 2022 (not only pension superannuation but also sovereign wealth funds, universities, insurers, endowment funds and foundations)[1].The investors of IFM collectively manage the retirement saving of over 120m working people.
- IFM has an open-ended 'evergreen' structure and acts as an intermediary between investors and infrastructure projects, providing expertise, governance, risk management, and value creation strategies.

Key observations

- This model has enabled the funds to develop a centralised expertise for investing in the asset class where no individual fund at that early stage had sufficient scale to build that skill.
- Because the Australian market has scale and the existing pool of assets are invested for the long term, the exposure to infrastructure is relatively high – in the range of 5%-10% for most major funds with largely stable or growing asset pools (in the UK it has exposure to Manchester Airports Group and Anglian Water as examples).
- There is a favourable fee environment and due to scale, IFM has been capable of delivering strong investment returns.
- IFM engages with its investors through various formal and informal channels, such as shareholder advisory boards, investor advisory committees etc and collaborates with investors on new products and bespoke solutions that reflect their ESG policies and preferences.
- IFM seeks to align its investment management approach to the needs and objectives of its investors, who are mainly institutional funds such as pension, superannuation, sovereign wealth, insurance and endowment funds.

1 - https://www.ifminvestors.com/en-gb/

Illustration of the structure



Private capital structures - existing

06

Summary of existing PC structures

Approach to structures

- In the following section, we present a selection of common structures in the PC market. They differ in their approach to risk, specifically in terms of the level of diversification, and level of investor control and exit options.
- We appreciate there is wide variation in the operations of these structures and various exceptions or nuances exist (particularly in relation to legal form or vehicle), but for the purposes of this illustration and to assist in comparison we have focused on the primary, distinguishing features.
- For purposes of illustration we have taken LPF to represent a typical closed-ended blind pool Private Capital fund with multiple investors. Similarly, we refer to a SMA structure in the context of a single investor with multiple direct investments.

Key features

- For simplicity we have focussed on risk as defined, primarily by level of diversification and available asset class.
- Returns are characterised as capital appreciation, either on sale of underlying assets or accumulating value, or income generation, based on a profit share from the underlying investment or a cash flow from the fund.
- In referring to liquidity, it is important to distinguish between the liquidity of the investment in the underlying asset and the liquidity of the individual investor's stake in the investment. Funds invested in illiquid assets may offer investors ability to exit.
- Finally, whilst there exists options to dispose of interests via a secondary market, in this section we focus on the relative liquidity and exit route in the fund itself. The secondary market is covered in more detail in relation to emerging structures.

Structure	Risk	Return type	Liquidity and exit	Control	Tax	Legal and regulatory	Fees	Communications
Limited Partnership Fund	Diversified	Primarily capital appreciation on asset disposal	Illiquid assets, Closed-ended	Delegated, with full discretion to GP	Tax transparent	Unregulated product, Limited liability	Management fee and carried interest	Varied by fund, confidentiality constraints
Fund of Fund	Increased diversification	Primarily capital appreciation on asset disposal	Illiquid assets, Closed-ended	Delegated, with full discretion to FoFM	Tax transparent, (depending on structure)	Unregulated product, Limited liability	Management fee and carried interest	Increased complexity, confidentiality constraints
Co-investment	Not diversified	Dependent on nature of investment	Illiquid (direct investment)	Investor influence, but GP lead	Optimisation of entry route available	Not regulated, Liability based on legal form	Low/no fees, Transaction costs	Tailored to investor
Separate managed account	Reduced diversification	Dependent on nature of investment	Illiquid (direct investments)	Investor control, with direct mandate to PC	Optimisation of entry route available	Not regulated, Liability based on legal form	Management / performance fee, Transaction costs	Tailored to investor, increased complexity
Semi-open ended fund	Diversified, but limited by available assets	Capital appreciation, and income distribution	Liquid and illiquid assets, Semi-open ended	Delegated, with investor options on exit timing.	Potentially increased tax complexity	Unregulated product, Liability based on legal form	Management / performance fee, Redemption charges	Varied by fund, confidentiality constraints

Limited Partnership Fund (LPF)

Often used for closed-ended private investment fund structures. These are efficient structures that provide the potential for higher returns. However, challenges with platform compatibility, regulation and lower levels of liquidity may be perceived as less attractive to some pension schemes.

Description of the structure

- In a typical multi-investor scenario, this is used to invest in a portfolio of companies.
- A Private Capital firm (often referred to as a General Partner or GP) raises irrevocable capital commitments from investors (known as Limited Partners or LPs) to start a closed-ended fund.
- The fund then draws down capital from investors to invest in a portfolio of private companies, mainly during the first five years of the fund's term. The fund will exit/realise most of its investments after this investment period, thereby generating returns for investors during the second half of the fund's term.
- The duration of a fund can vary but is typically in the region of 10 -15 years.

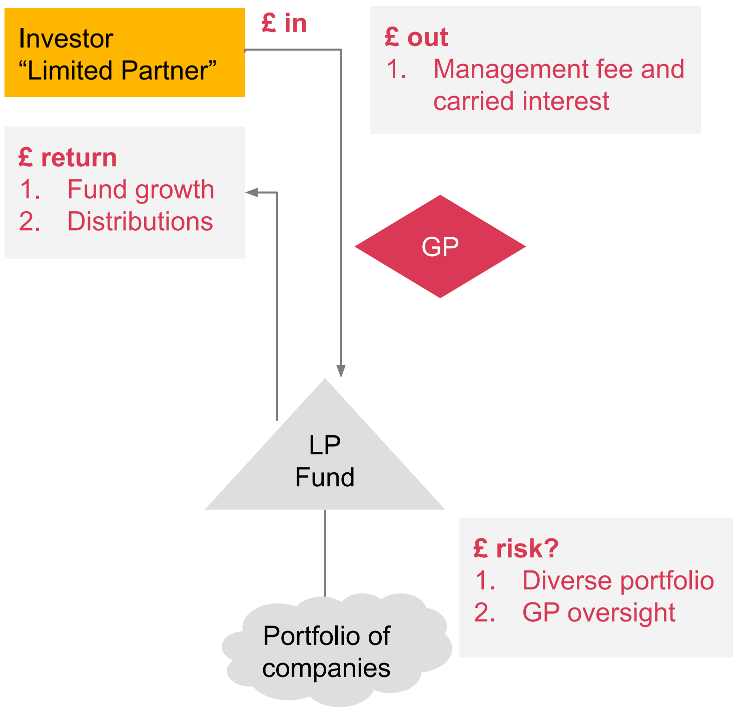
Current uses and why they are used

- LPFs offer a flexible structure which allows investors to have access to pooled capital with management and control delegated to a professional manager (GP).
- LPFs are the dominant structure for Private Capital funds globally, and enable the provision of long-term capital, with limited liability and tax transparency.

Key observations

- The LPs, who are passive investors, have limited involvement in fund decisions, however, due to the limited liability structure, the exposure of the LP is limited to the specific amount of their investment.
- The GP has management responsibilities, such that they make decisions on the acquisitions, exits, and governance of the portfolio. The GP charges management fees and receives 'carried interest' on exit.
- The structure allows for the pooling of funds from multiple investors, making it easier to attract capital. It offers flexibility in profit sharing between LPs based on agreed partnership terms.
- There is the potential for higher returns when compared to public market equivalents. This is a reflection of the illiquidity, complexity, and risk premium (including higher leverage) of Private Capital investments.
- Distributions are received from the fund based on an agreed exit strategy; usually as the portfolio companies are sold, or less typically, as cash flows are generated.
- Generally fixed term and illiquid, and suitable for investors who can commit to a long term investment (secondary markets can also be used to provide liquidity, if required).
- This is generally a tax efficient structure, with tax paid by the investors on their returns (typically capital gains) and not the fund itself. This helps to avoid double taxation and is known as tax transparency.
- The funds are typically unregulated, professional investor products in the UK and elsewhere (hence the flexibility in terms), although the fund's management firm will be subject to general financial services regulation and specific frameworks (such as UK or EU AIFMD).
- There is an increasing incentive for LPFs to adapt to respond to meet the needs and expectations of pension schemes and members, for example to meet the ESG objectives of pensions funds.

Illustration of the structure



Limited Partnership Fund: Comparative analysis

Potential advantages and limitations across each of the assessment criteria

	Private Capital perspective	Pension Sector perspective
Risk	• Opportunity to diversify risk by holdings through a portfolio of assets in a fund • LPs are passive investors whose risk exposure is limited to its commitment.	• Increased choice in the market provides comfort over diversification/investment strategy, and experienced GPs can demonstrate a track record. • Typically valued quarterly which may present uncertainty for DC schemes, which are accustomed to daily pricing of assets.
Return	• Potential for higher returns, alongside illiquidity and complexity. • Investors typically receive distributions after a fixed 'investment period' (usually 5 - 10 yrs)	• Greater potential for higher returns when compared with traditional investments, with risk somewhat mitigated via fund diversification. • Returns difficult to predict with most being based on proceeds on the sale of asset therefore the generation of regular cash flows from returns is uncommon.
Liquidity and exit	• Liquidity constraints may limit investors' ability to meet cash flow needs or respond to market changes. • The secondary market may provide the opportunity to sell interests in LPFs to other investors over the short/medium term.	• Potential for cash flow matching across a large pool of members could help to mitigate liquidity constraints. • The exit strategy is determined by fund terms.
Control	• LPs do not have control over fund investment decisions. • Ongoing monitoring and reporting provided by fund.	• Control outsourced to the GP. This helps to save costs of an in-house team, but creates some risk. • Opportunity to align objectives between the investor and fund manager.
Tax	• Tax benefits with LPs taxed on their share of the fund's income and gains, with no additional layer of tax at the fund level. • Tax leakage of overall structure will depend on how assets are held by the fund.	• Tax efficient and transparent structure, avoiding double taxation. • Possible need to file overseas tax returns (US in particular, assuming income not "blocked" by a feeder vehicle which may have its own tax profile)

Limited Partnership Fund: Comparative analysis

Potential advantages and limitations across each of the assessment criteria

	Private Capital perspective	Pension Sector perspective
Legal and regulation	• Limited Partnership laws and absence of product regulation permits more freedom around fund terms albeit, this also increases potential risks and expertise required to manage. • Limited liability structure offers protection to investors.	• Due diligence and transaction legals are typically handled by the fund. • Potential for regulatory and legal challenges for use in pension sector, with increased legal and monitoring costs due to complexity.
Fees and costs	• GP charges fixed management fees on LP's commitments and receives a profit share ('carried interest') once capital has been returned to investors, if profits from asset sales exceed a preferred return level (typically 8%) • LPs may also bear some or all of the fund's expenses, which may include due diligence, legal, audit, consulting.	• Management and carried interest are higher than other assets. • There are reduced compliance costs, given the regulation is at the Private Capital firm level as opposed to the product level.
Communications	• The LP receives regular communications from the fund manager and the fund, such as capital call notices, distribution notices, financial statements, valuation reports, and annual meetings.	• Additional reporting/information may be needed for DC members. • Standard information to investors will be different from that characteristic of public markets.

Limited Partnership Fund of Funds (FoF)

A fund invested in a portfolio of underlying funds. Fund-of-funds may either have a primary focus (i.e. make investments in new funds) or pursue a 'secondaries' strategy by purchasing second hand interests in underlying funds which have already deployed capital into companies.

Description of the structure

- A fund invested in a portfolio of funds (either as an initial investor in a new fund or as a secondary investor purchasing interests in maturer funds where capital has already been invested into companies).
- A fund of funds manager ("FoFM") acts as a GP and raises capital from LPs to invest in a diversified portfolio of underlying funds, which in turn invest in private companies.
- Typical investment duration is 10-15 years.

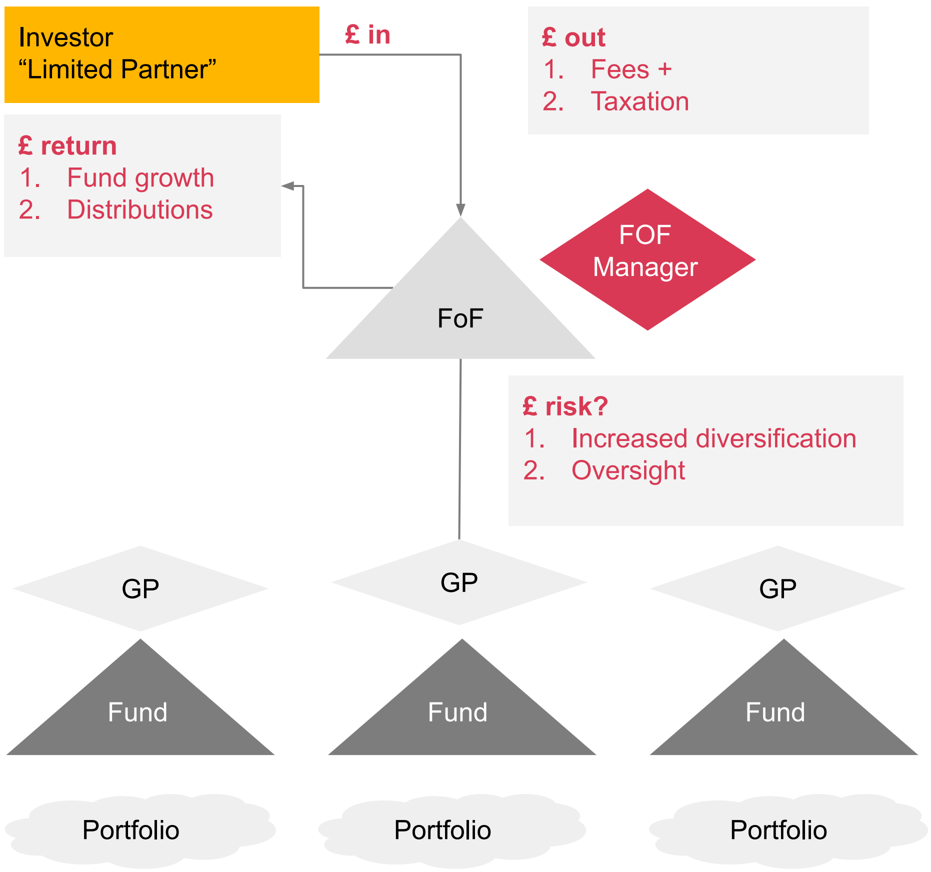
Current uses and why they are used

- Typically used by investors, including smaller investors, who want to diversify their exposure to Private Capital, but may not have the resources or expertise to invest directly in individual funds.
- They are suited to investors who prioritise diversification in risk management, with risk spread across different strategies, managers, and asset classes.

Key observations

- The LPs have limited control over the fund of funds, but can establish a close relationship with FoFM for customisation and tailored investment solutions.
- Investors can access the professional expertise of fund of fund managers who make decisions on the selection, allocation, and monitoring of the underlying funds.
- There is a relatively higher fee structure with further fees charged by the FoFM as well as the GPs of individual funds in its portfolio.
- FoFs allows investors to gain exposure to multiple strategies through a single investment vehicle.
- FoFs provide increased diversification, but information and reporting can be complex.
- Returns are primarily from asset sale proceeds, although some investments may be structured to generate annual returns.
- These structures are generally fixed term and illiquid, albeit there are some examples of publicly traded fund of funds.
- It can be a tax efficient structure, with tax paid on investor income, not the fund itself, avoiding double taxation. As with LPFs, FoFs are generally not subject to product regulation.

Illustration of the structure



Limited Partnership Fund of Fund: Comparative analysis

Potential advantages and limitations across each of the key consideration categories

	Private Capital perspective	Pension Sector perspective
Risk	• Increased diversification with portfolios across multiple funds which helps to manage risk but adds complexity. • Leverages additional buying power and broader expertise.	• Provides exposure to a broader range of Private Capital opportunities and managers. • Valuation - Typically valued quarterly within 60/90 days of quarter end. DC schemes are accustomed to daily pricing of assets. Valuation will not be available on a daily basis.
Return	• In some situations there is less visibility on fund performance with complex monitoring across multiple portfolios.	• Increased diversity across funds and asset classes allows for wider choice of return mechanisms.
Liquidity and exit	• Low liquidity, as the investment is normally in closed-ended funds that typically have a lock-up period of 10 to 15 years. • This means there could be limited ability to adapt to changing circumstances.	• Potential to manage liquidity constraints across fund cycles, strategies, regions, and sectors.
Control	• Although there is the ability to leverage the expertise of multiple GPs and FoF managers, the complexity of managing multiple investments creates risk in effective performance monitoring. • There is limited control over the underlying assets, investment decisions and management taken by the fund managers.	• Control outsourced to FoFM with risk managed through broader expertise and deeper track record. • Close relationship between investor and FoFM, can supplement in-house pension management/investment strategy team.
Tax	• Tax benefits with LPs taxed on their share of the fund's income and gains, rather than at the fund level. • Tax leakage of overall structure will depend on how assets are held by the fund(s).	• Tax efficient and transparent structure, which avoids double taxation. • Possible need to file overseas tax returns (US in particular, assuming income not "blocked" by a feeder vehicle which may have its own tax profile).

Limited Partnership Fund of Fund: Comparative analysis

Potential advantages and limitations across each of the key consideration categories

	Private Capital perspective	Pension Sector perspective
Legal and regulation	• Similar to the LPF structure, with benefits from the absence of product regulation and limited liability. • May create multiple layers of legal obligations, as the investor may be subject to the terms and conditions of the FoF agreement and the underlying fund agreements.	• Similar to LPF, there is the potential for regulatory and legal challenges for use in the pension sector, with increased legal and monitoring costs due to complexity.
Fees and costs	• FoF manager ordinarily charges a fixed management fee and may also receive a performance element. • However, there could be higher fees overall as there is an extra layer of fees to the FoF manager and underlying fund managers	• There could be a higher fee burden for no increased return which needs to be balanced against the savings on in-house resource and reduced compliance costs. • Ongoing monitoring and reporting provided by fund.
Communications	• The FoF has to rely on the information and reporting provided by the underlying fund managers. • The information may be more complex and based on consolidation of underlying funds.	• Similar to the LPF structure, this presents challenges for pensions investors to comply with the level of information required for members.

Co-investment

Direct investment alongside a fund into a portfolio company presents opportunity for higher returns and greater investor involvement. Often with no additional fees, however, it is likely that a scheme would need significant scale in order to manage the illiquidity of this structure.

Description of the structure

- Direct investment into a company held by a fund.
- The GP/Fund manager invests LP capital directly into a portfolio company of a fund that the LP is already involved in.
- These investments are typically held for 3-15 years (depending on the asset class).

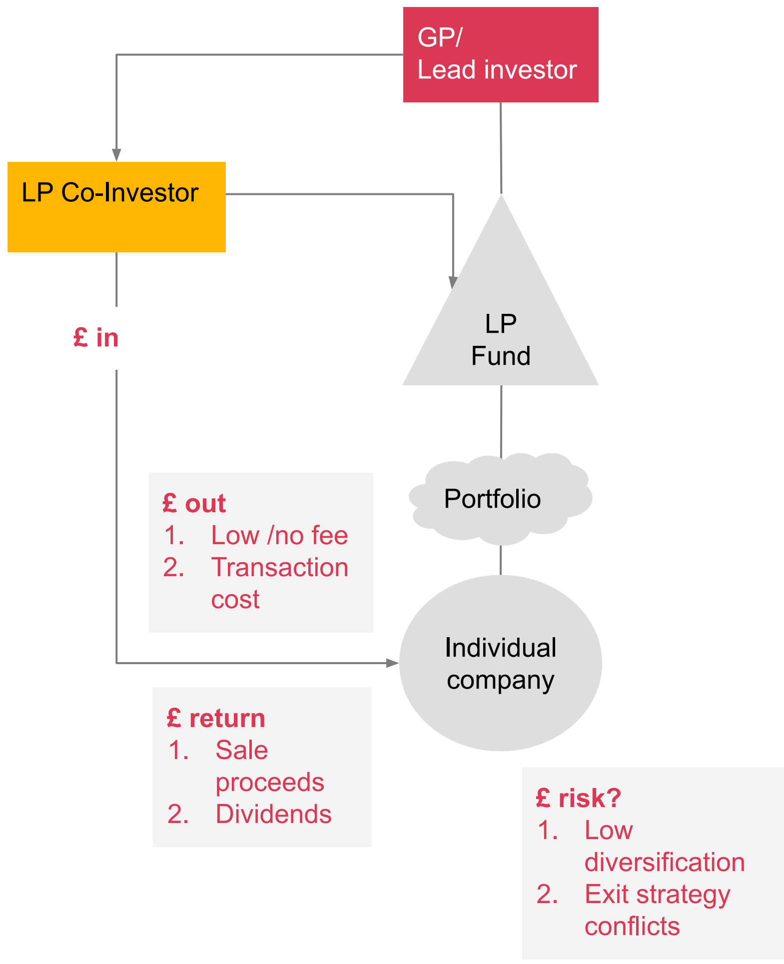
Current uses and why they are used

- Co-investment is typically used as a means to enhance potential returns, reduce fees, or gain more direct access and influence over the underlying assets.
- This structure can provide investors with the ability to increase their exposure to and focus in targeted sectors or transactions space.
- Co-investment can include investments in a specific deal or transaction but options are usually limited to existing fund relationships.

Key observations

- Provides an option for LP to have control and influence in the investment company, but this brings liability for investors compared with LPFs. As the investor has direct ownership of the asset they may have exposure to a greater level of third party or contractual liabilities.
- The co-investment opportunity is often recommended by a GP from a pre-existing fund, meaning both the GP and LP already have some prior experience and insight of the company.
- Minimal or no fees are payable to fund manager and there will be other cost efficiencies. However, costs could be higher in other areas such as due diligence and management time.
- Potential for higher returns when compared to a fund, but there could be greater risk due to absence of diversification and increased complexity.
- One of the key advantages is that there is opportunity for choice of specific investment, but also potential for conflict on exit strategy with other investors or company management.
- Co-investment is often Illiquid and long term in nature, with the potential for annual returns based on profitability.
- There is also the potential to optimise portfolio tax efficiency by benefitting from favorable tax treatment and optimising entry route for investor when compared to fund investments.

Illustration of the structure



Co-investment: Comparative analysis

Potential advantages and limitations across each of the key consideration categories

	Private Capital perspective	Pension Sector perspective
Risk	• Inherently risky due to the lack of diversification, but co-investment can be used as a means to diversify an investor's wider portfolio. • Higher operational and reputational risks, as investors may bear more responsibility and liability to individual companies (depending on the vehicle chosen).	• Investors do tend to have some experience of the company through the fund, with some visibility on track record to date. • Risk of losing more than the initial capital invested if, over time, the co-investment opportunity requires more funding. • Risk can be mitigated through limited partnership or corporate vehicles
Return	• Offers the potential to enhance portfolio returns by accessing attractive opportunities. • Investment entity may benefit from co-investors' expertise and value creation strategies which may enhance the return further.	• Often more favourable terms than through the fund, and potential to negotiate a profit based share for regular cash flows/annual return. • However, there is likely to be greater uncertainty and volatility.
Liquidity and exit	• Higher illiquidity, with limited options for investors to sell or transfer their stake. • There are considerable exit risks, as exit is dependent on the company's performance, market conditions, and consensus amongst investors and company management.	• Illiquid investment, but there is potential to target shorter-term, faster paybacks e.g. focused on a specific deal or project. • Customised exit strategies may lead to potential for conflicts with other stakeholders.
Control	• Opportunities are selected by a GP who has pre-existing knowledge of the company and experience in assessing investment potential. • Investors have more control and influence over the company, this can be good for those investors with existing experience in a given sector.	• Opportunities can be aligned to an investor's risk preference. However, there is the potential risk of bias from a lead investor who is recommending the investment. • Increased control requires additional commitment from pension investor but provides an opportunity to build sector experience and leverage expertise, networks, and resources of co-investors.
Tax	• Potential to optimise portfolio tax efficiency by having more favorable tax treatment, based on an optimal entry route for the individual investor, as well as benefiting from the lead investor's tax expertise and structuring.	• Direct investment creates a position of tax simplicity by schemes.

Co-investment: Comparative analysis

Potential advantages and limitations across each of the key consideration categories

	Private Capital perspective	Pension Sector perspective
Legal and regulation	• Due diligence has often already been carried out on the asset in fund, with updated analysis provided by the GP offering the opportunity. • However, there could be complexity in the assessment of individual opportunities and the execution of transactions.	• Need to avoid over-reliance of GP's information and analysis. • Direct investments in unlisted securities may cause regulatory concerns, for example, in relation to permitted links rules on the types of investment that pension schemes are allowed to hold.
Fees and costs	• Minimal or no fee to GP, lower fees and costs than fund investments. • Co-investment benefits from GP's economies of scale and bargaining power. • If further due diligence is required, this will add to the costs.	• Additional, independent due diligence will likely be necessary to confirm whether the investment aligns with the pension scheme objectives. • Pension scheme may feel additional pressure to support a struggling asset with further funding, particularly where there is potential reputational impact.
Communications	• Increased involvement in a specific company presents an opportunity for investors to request more frequent and detailed reporting and disclosure than fund investments.	• Making information on individual co-investment available to members could be costly and increase complexity of comms to members. • Potentially attractive for members if investments align with an investors' objectives, social responsibility or ESG sector.

Separate Managed Account (SMA)

To support a focussed strategy of direct investments, aligned to the investor's objectives, with the support of a dedicated Private Capital manager. It creates risk due to reduced diversification with difficulties in achieving necessary scale for institutional investors.

Description of the structure

- A customised portfolio of direct investments in private companies.
- Managed by a professional Private Capital Manager (PCM) and tailored to meet the needs of an individual investor.
- This could be part of an ongoing investment programme with minimum three year duration.

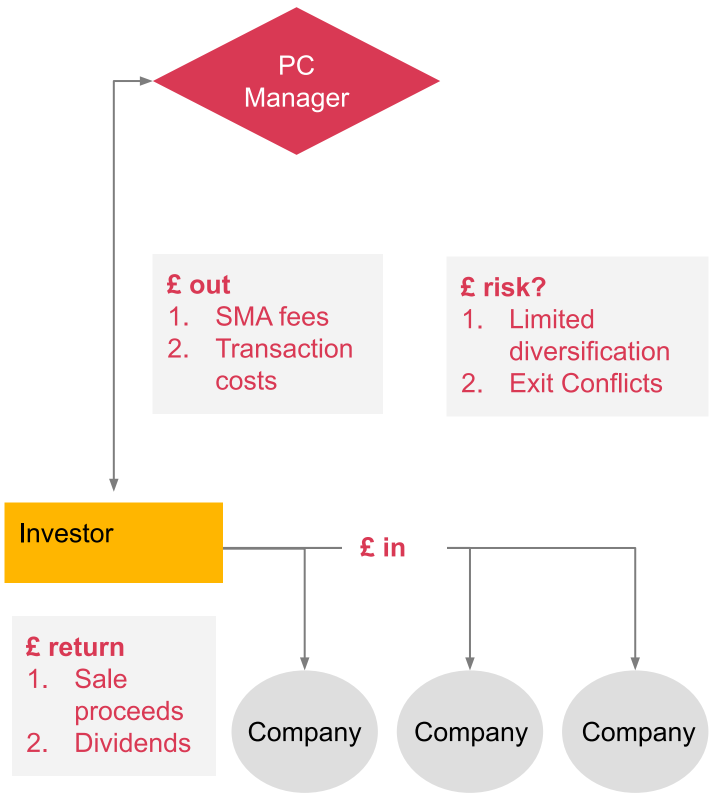
Current uses and why they are used

- Typically used by investors seeking control and direct ownership of their portfolios to pursue a focused investment strategy, aligned to the interests and expertise of the investor.
- This is similar to co-investment but without requiring the investor to be a LP with an existing fund. As such, there is potential for more alignment with the individual investor; targeting investments on specific deals, transaction types, or a particular sector.

Key observations

- Investors have direct decision making authority and control over the portfolio, reducing the risk of misalignment of interests or bias from pre-existing fund relationships.
- A Private Capital manager identifies a customised and discretionary portfolio of direct investments to a single or small number of investors.
- Although management fees and performance fees are likely to be payable, there is greater potential for these to be negotiable when compared to fund manager fee structures.
- The dedicated role of the PCM fosters a direct alignment of interests, with a strategy focused on the investor's goals and objectives.
- This could be a means of providing access to specialised or niche strategies that are not widely available in other vehicles (as not restricted to investments from pre-existing fund relationships).
- Potential for liability above capital invested due to beneficial ownership basis of assets, with the risk of a greater level of contractual or third party liabilities falling on investor. However, this can be mitigated by the chosen vehicle, for example a limited partnership fund..
- Provides flexibility in managing liquidity, as investors can have more control over the investment durations and exit strategies (the use of secondary markets may also be considered to manage liquidity as needed).
- These structures are tax efficient and transparent. Investors can also reduce tax leakage and complexity with an optimised entry route tailored to their circumstance.

Illustration of the structure



Separate managed account: Comparative analysis

Potential advantages and limitations across each of the key consideration categories

	Private Capital perspective	Pension Sector perspective
Risk	• Allows for more diversification of assets than co-investments, but the focus is on direct investments which brings risks, with investor responsibility and liability. • Risk of losing more than capital invested, however the risk is tailored to the investor's risk appetite and preference.	• Exposure to a broader range of direct investment opportunities (not limited to involvement with investment in pre-existing funds) • Lower diversification than funds.
Return	• There is the potential for higher returns when compared to funds. • It is also possible to negotiate lower fees, better terms and more favourable exit options.	• Increased diversity of investments (relative to co-investments) allows for a wider choice of return mechanisms. • Relatively higher levels of uncertainty on individual investors which may result in uncertain returns.
Liquidity and exit	• Potential for more liquidity and exit flexibility than funds or co-investments, with investors able to take a more targeted approach to their portfolio. • Investors can often have more influence over investment duration, redemption and distribution preferences.	• As with co-investments, there is the potential to target shorter-term, faster paybacks. • Investors could have control over buy and sell decisions. • The potential for conflict with other investors/management can be somewhat managed through this portfolio approach.
Control	• Can select a PCM with a strong track record and expertise. • However a PCM may have limited experience with the company if it is not part of an existing fund. • Supports investor objective for focus on a specific sector, allowing them to build experience and reduce complexity of portfolio.	• Close relationship between investor and PCM, can supplement in-house pension management or investment strategy team.
Tax	• Potential to optimise portfolio tax efficiency by having more favorable tax treatment, based on an optimal entry route for the individual investor. • However, investors may face more risks and tax compliance issues due to need to consider schemes' unique tax profiles.	• Generally SMAs have the potential to offer more control over tax-related decisions, such as realising capital gains or losses, managing tax implications based on their individual circumstances.

Separate managed account: Comparative analysis

Potential advantages and limitations across each of the key consideration categories

	Private Capital perspective	Pension Sector perspective
Legal and regulation	• Complexity in assessment of opportunities and execution of transactions. • Full due diligence and transaction responsibilities.	• As with co-investments, SMA direct investments in unlisted securities may cause regulatory concerns including in relation to permitted links.
Fees and costs	• The PCM will likely charge fixed management fees and an ongoing fee contingent on SMA performance. • Typically there are higher upfront and ongoing costs when compared to funds.	• Higher fee burden, will need to be balanced with savings on in-house resource. • Share of liability may lead to pressure for additional cash support to investments.
Communications	• Requires close monitoring and communication from the PCM/investor to evaluate the investment strategy and performance of the portfolio. • PCM role may support with more direct and frequent communications with portfolio companies.	• Potential to provide consolidated information at SMA level more efficiently. • SMA portfolios of companies that operate in similar sectors focus may be easier to explain to members.

Semi-open ended Private Capital fund

The semi-open ended structure offers liquidity options which are usually not possible in traditional PC investments, but may lead to a reduced choice of underlying assets. It has benefits and limitations similar to a fund of fund structure.

Description of the structure

- A fund invested in a portfolio of companies and/or funds, offering increased liquidity.
- A hybrid structure which offers some liquidity and lower minimum investment requirements than traditional closed-ended funds.
- Typically achieved by an initial lock-in period followed by predetermined intervals for redemptions, or there is potential to sell a holding via a secondary market.
- Duration will vary depending on the fund's strategy with an increasing number of 'evergreen' options.

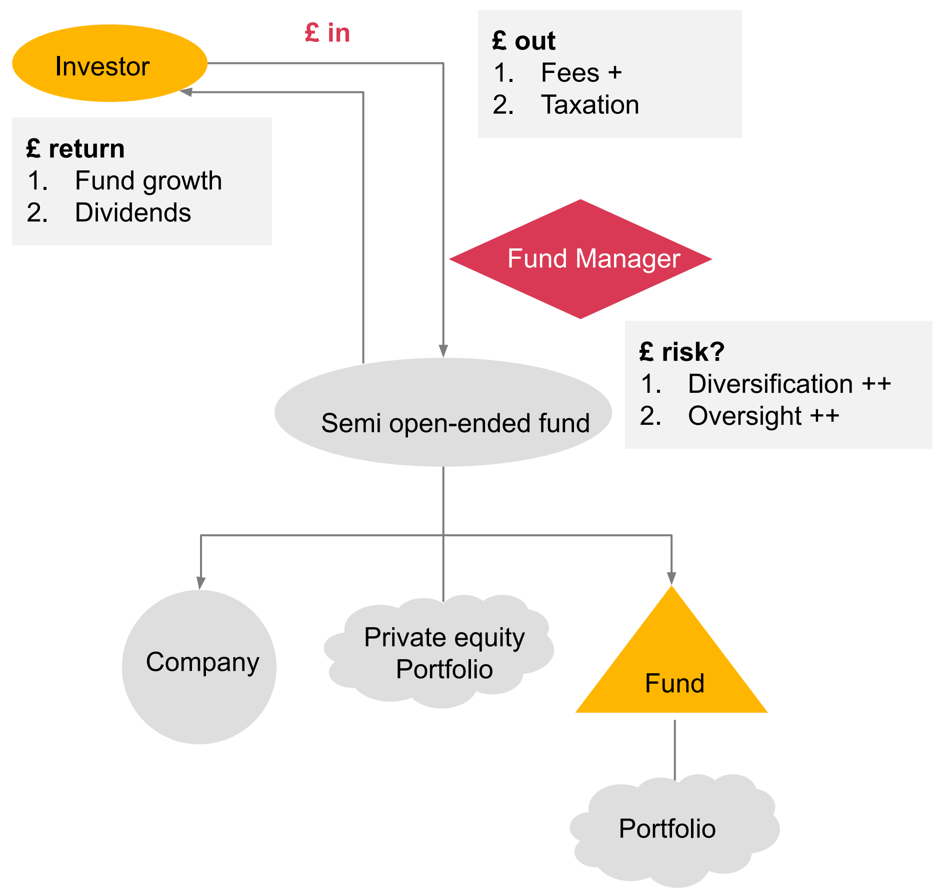
Current uses and why they are used

- Typically used in retail and wealth management but increasingly being used by broader investors who want potential for higher returns which are usually only accessible via closed-ended structures.
- These types of structures provide more flexibility on liquidity.

Key observations

- The fund may invest directly in private companies or indirectly through other funds, but the investor will have limited control and involvement with the underlying assets.
- There is normally a fully managed service, with a fund manager or investment committee responsible for sourcing, executing, monitoring, and exiting the fund's investments.
- The fund manager will charge management fees and performance fees to the investors.
- These types of funds can have a fixed or variable capital structure, and may allow investors to subscribe and redeem their shares or units at periodic intervals, subject to lock up periods, redemption fees, notice periods and gating (investor or fund level).
- There will be higher levels of liquidity and lower minimum investment requirements than traditional funds.
- Some may also charge redemption and exit charges to discourage early withdrawals or to help align the interests of the investors.
- These structures may have complex or varied tax implications depending on fund status as well as investor status.

Illustration of the structure



Semi-open Ended Private Capital Fund: Comparative analysis

Potential advantages and limitations across each of the key consideration categories

	Private Capital perspective	Pension Sector perspective
Risk	• Exposure is managed through liquidity options which allow investors to withdraw from investments more readily than closed-ended structures. • Diversity of assets may however be restricted due to the unique liquidity objectives and limited availability.	• As with other PC funds, performance and valuations will not be easy to monitor (compared with the daily market values of listed assets).
Return	• Offers flexibility and discretion over when and how to realise returns, which can be on asset disposal or dividend basis. • Requires bespoke monitoring to measure fund performance.	• Can provide access to higher return assets, but returns are usually lower than fixed-term funds.
Liquidity and exit	• Increased liquidity (though still limited), with investors able to redeem or subscribe at certain intervals, subject to terms and fees. • Offers a range of exit strategies, aligned to investor's interest with ability to adapt to changing circumstances. • Liquidity offered may result in a drag on performance	• Liquidity options in this space are likely to be complex. • Pension investor can make decisions in their own interest without the need for consensus with other investors.
Control	• Investment and operational decisions are delegated to a fund manager, therefore limited control rights for investors. • Defined reporting obligations to investors, provide transparency and accountability on the fund's activities.	• Control is outsourced to a Fund Manager; which means that there isn't a need for an in-house team, but this creates some risk due to the lack of influence. • There is also the opportunity to align objectives between investor and fund manager.
Tax	• May have complex or varied tax implications depending on fund status as well as investor status	• The tax profile of such funds will depend on the specific structure of the fund. Most such funds will be regarded as tax opaque, so will vary depending on legal structure and location.

Semi-open Ended Private Capital Fund: Comparative analysis

Potential advantages and limitations across each of the key consideration categories

	Private Capital perspective	Pension Sector perspective
Legal and regulation	• Governed by the fund's legal documents and subject to laws and regulation of the countries where they invest and operate.	• As with other funds, there is the potential for regulatory and legal challenges when used in the pension sector, with increased legal and monitoring costs due to lack of information and control.
Fees and costs	• Fixed management fees, performance fees, and other fees/costs, such as subscription fees, redemption fees, transaction fees and expenses.	• The higher fee burden will need to be assessed against service/expertise provided by the Fund Manager and saving on in-house teams.
Communications	• Regular and transparent communications with investors via meetings, investor portal, financial statements, etc.	• Additional reporting/information needed for DC members. • Details of assets in fund may be confidential to fund, preventing full disclosure to pension members.

Private capital structures - emerging options

07

Summary of emerging PC investment options

Whilst emerging options offer targeted solutions on specific challenges, we also find new challenges created. This emphasises the need to truly understand the barriers and incentives required to unlock investment.

Approach to emerging options

- In the following section, we present a selection of emerging PC investment options. These are built on or have evolved from features of existing structures, and differ in their approach to regulatory involvement, basis of returns, and liquidity.
- These emerging options attempt to improve on some of the perceived limitations or barriers to wider uptake of the traditional structures. However, these may also create limitations of their own, for example a potential liquidity drag on performance or additional costs / loss of value on redemption.
- As before, we appreciate there is wide variation in the operations of these structures which are continuing to evolve, but for the purposes of this illustration and to assist in comparison we have focused on the primary, distinguishing features.

Key features

The emerging options are characterised by some distinguishing features as follows;

- The use of a regulatory wrapper - applied to an established structure – to enhance investor protection, with additional governance, oversight and reporting requirements.
- Increased flexibility for timing or nature of returns is offered through mid-term realisation options or stable income distributions.
- The liquidity challenge is tackled through; inclusion of a liquid asset mix, fund-based redemption routes, realisation via a secondary market (or a combination of all).
- The interface with a secondary market is an increasing feature.

Structure	Risk	Return type	Liquidity and exit	Control	Tax	Legal and regulatory	Fees	Communications
LTAF	Diversified, but limited by available assets	Capital appreciation -accumulating units	Majority Illiquid, Semi-open ended	Delegated	Majority Tax transparent	UK regulated, Limited liability based on legal form	Management / performance fee aligned with regulator	Consistent by fund, defined by regulator rules
ELTIF	Diversified, but limited by available assets	Capital appreciation - accumulating units	Mix of liquid and Illiquid assets, Closed-ended Secondary market	Delegated	Majority Tax transparent	EU regulated, Limited liability based on legal form	Management / performance fee aligned with regulator	Consistent by fund, defined by regulator rules
Perpetual fund	Diversified, but limited by available assets	Income generation -distributing units	Limited liquidity, Secondary market	Delegated, with investor options on entry/ exit timings	Dependent on nature of investment	Based on jurisdiction and legal form	Management fees, other fund specific fees	Varied by fund, potential confidentiality constraints

Long Term Asset Fund (LTAF) (authorised fund)

The open-ended structure brings enhanced flexibility and FCA regulation offers protection - however, this is a new structure and liquidity options may come at a cost to returns.

Description of the structure

- A UK domiciled open-ended fund that is authorised and regulated by the FCA.
- Authorised Funds (AF) are regulated by the FCA.There are different categories of AF which are distinguished by level of investor protection, diversification, liquidity, and leverage of the fund.
- LTAF is a new category of AF, designed by UK regulators with DC/institutional and mass-market retail investors in mind, but it can also be marketed to a broad range of investor types. It is an open-ended fund, with a continuous 'evergreen' life span.

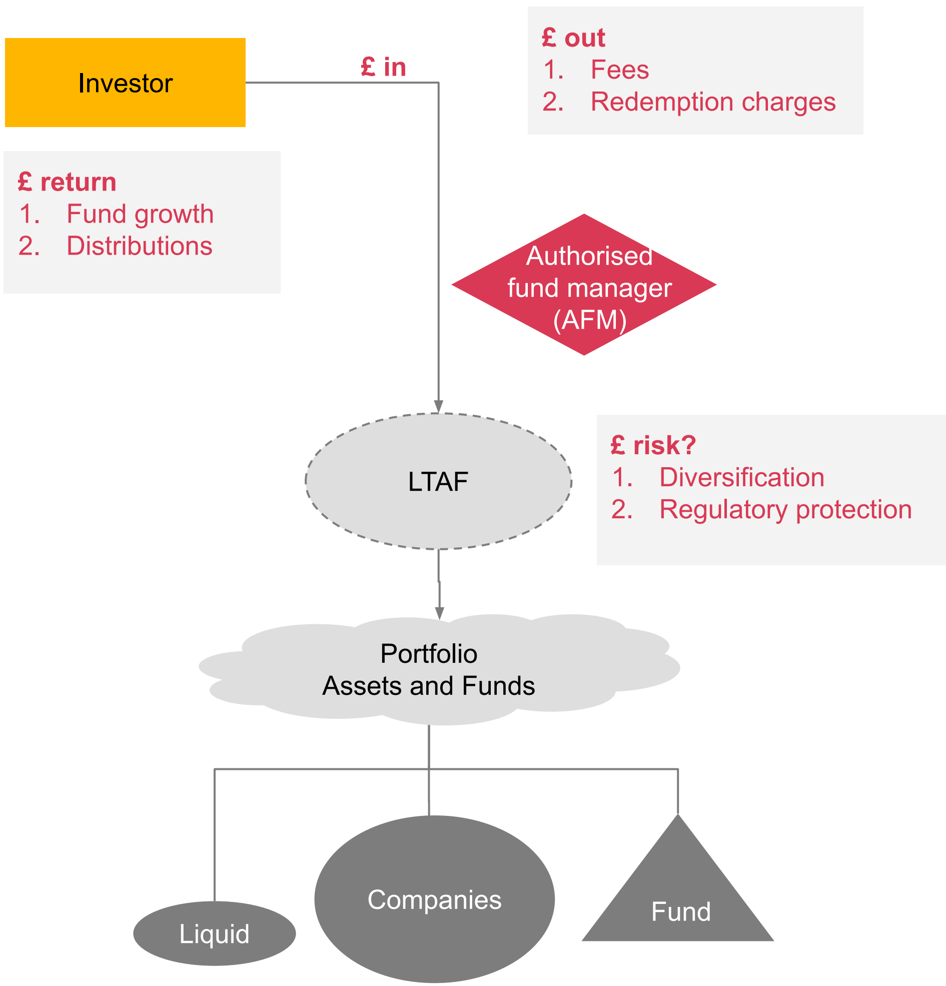
Current uses and why they are used

- Authorised funds are common in the UK and may be structured as an open-ended investment company (OEIC), authorised unit trust (AUT) or an authorised contractual scheme (ACS). They each have their own legal form, tax and operational features.
- LTAFs are designed to provide easier, simpler access for DC investors to long-term private market, illiquid investments such as infrastructure and private equity.
- An LTAF offers some liquidity to investors by allowing them to redeem their units at regular intervals (no more frequently than monthly), with potential to provide an income stream through distributions.

Key observations

- An updated LTAF structure was launched in 2023 following a consultation by the FCA and the Treasury on the detailed design, regulation and investor eligibility of the fund.
- It is designed to target institutional investors who can commit their capital for longer periods.
- Investor control is minimal, but may be offered a vote on certain fundamental matters at a general / extraordinary meeting of shareholders in accordance with FCA rules.
- LTAFs are managed by authorised fund managers (AFMs) who have specific duties under the FCA Rules and have discretion to make investment decisions.
- They are able to operate similar fee structures to traditional funds, but with additional fee transparency due to their regulated nature and are also subject to the FCA's assessment of value regime.
- They can adopt various legal forms, including limited liability structures, similar to an LPF.
- Liquidity could be restricted, with the focus being on longer redemption periods to provide higher returns and regular income.
- LTAFs are subject to FCA rules, but with more flexibility than some other authorised funds in areas such as valuation, liquidity management, disclosure and governance.

Illustration of the structure



Long Term Asset Fund (authorised fund): Comparative analysis

Potential advantages and limitations across each of the assessment criteria.

	Private Capital perspective	Pension Sector perspective
Risk	• FCA authorisation and UK domicile provides comfort on governance and transparency.	• Operational challenges to delivering the LTAF through platforms need to be worked through.
Return	• Over the longer term, returns are based on accumulating units receivable on asset sale / investor exit with potential for distributing units depending on the fund terms. • Liquidity offered by the LTAF may result in a drag on performance	• Could be structured so that they generate long-term and stable returns that match the liabilities and objectives of pension schemes. Specifically, an LTAF can generate capital growth for the accumulation phase and income for the decumulation phase. • FCA rules provide a consistent and transparent approach to valuations.
Liquidity and exit	• Illiquid assets with a fixed exit strategy, but with liquidity options available for investors to exit when they wish. These include periodic windows to withdraw/transfer capital or use of secondary markets to sell units. • Redemption frequency will be set by reference to the liquidity of the portfolio. Some LTAFs incorporate an initial lock in period. This may create a drag on performance compared to other structures.	• Open-ended liquidity offers some flexibility to adapt to changing circumstances or unforeseen cash flow needs (subject to pricing and fees). • Clear redemption policy, agreed at the outset by the fund manager with less risk of conflict between stakeholders. There is potential for the LTAF terms to be designed in collaboration with an anchor investor, which may be of particular relevance to DC investors given their scale. • The need to hold sufficient liquidity to match investor redemptions may create a drag on performance compared to other structures.
Control	• Operated by an authorised fund manager. Many private fund managers will not have the right permissions to carry out this function so a third party may be required to perform this role. • Investors have limited control on investment decisions, but do have contractual rights and obligations over the underlying assets.	• Control delegated to an AFM, saving costs of needing to have in-house team. There may be potential for a DC scheme to have some influence if they are a cornerstone investor. • FCA accreditation provides comfort over expertise and accountability. • Reduced customisation mitigated by the increased flexibility of an open-ended structure.
Tax	• LTAFs can be established in either tax transparent or tax opaque structures. • The Tax Elected Fund regime may be beneficial if a tax opaque structure is used.	• Tax transparent when optimally structured for pensions, with investors taxed on their share of the fund's income and gains, may be more appropriate for the DC space.

Long Term Asset Fund (authorised fund): Comparative analysis

Potential advantages and limitations across each of the assessment criteria.

	Private Capital perspective	Pension Sector perspective
Legal and regulation	• The LTAFs operation must be in compliance with the regulatory framework which includes detailed rules on governance/expertise, liquidity management and valuations. • Certain changes to the LTAF may require FCA approval.	• FCA authorisation helps with alignment of requirements for the pensions sector. • The LTAF is a “conditional permitted link” which can be helpful where the LTAF is intended to be offered through a unit-linked product.
Fees and costs	• Fees structures are varied, but AFM could charge a flat management fee (on NAV) and/ or performance fees. • Fund's expenses may include depositary fees and third party service provider fees, as well as due diligence, legal, audit, consulting, or transaction costs (as per other funds).	• Fees are generally lower than in the context of unauthorised products. • The LTAF is subject to an annual “assessment of value” which guards against excessive costs being incurred. • Fees may be considered high, but as a fully managed service with regulatory compliance it may be a valuable option to pension investors.
Communications	• Investors receive quarterly, semi-annual and annual reports.	• Adherence to FCA rules on reporting help to ensure transparency and consistency in information to members.

European Long Term Investment Fund (ELTIF)

A closed-ended structure, regulated in the EU and designed to promote institutional investment in targeted sectors of the EU economy - however, liquidity options are limited and their relative complexity has led to limited uptake to date.

Description of the structure

- A closed-ended, alternative investment fund which is subject to EU regulation.
- Alternative Investment Funds (AIF) are collective investment structures, the management of which is regulated under UK or EU AIFMD.
- ELTIF is a relatively new type of EUAIF, aiming to promote investment in certain segments/sectors in the EU (ie. infrastructure, SMEs, research, renewables).
- It is closed-ended* with a minimum duration of 10 years and there are rules on the types and proportion of assets invested (at least 70% in EU illiquid assets).

Current uses and why they are used

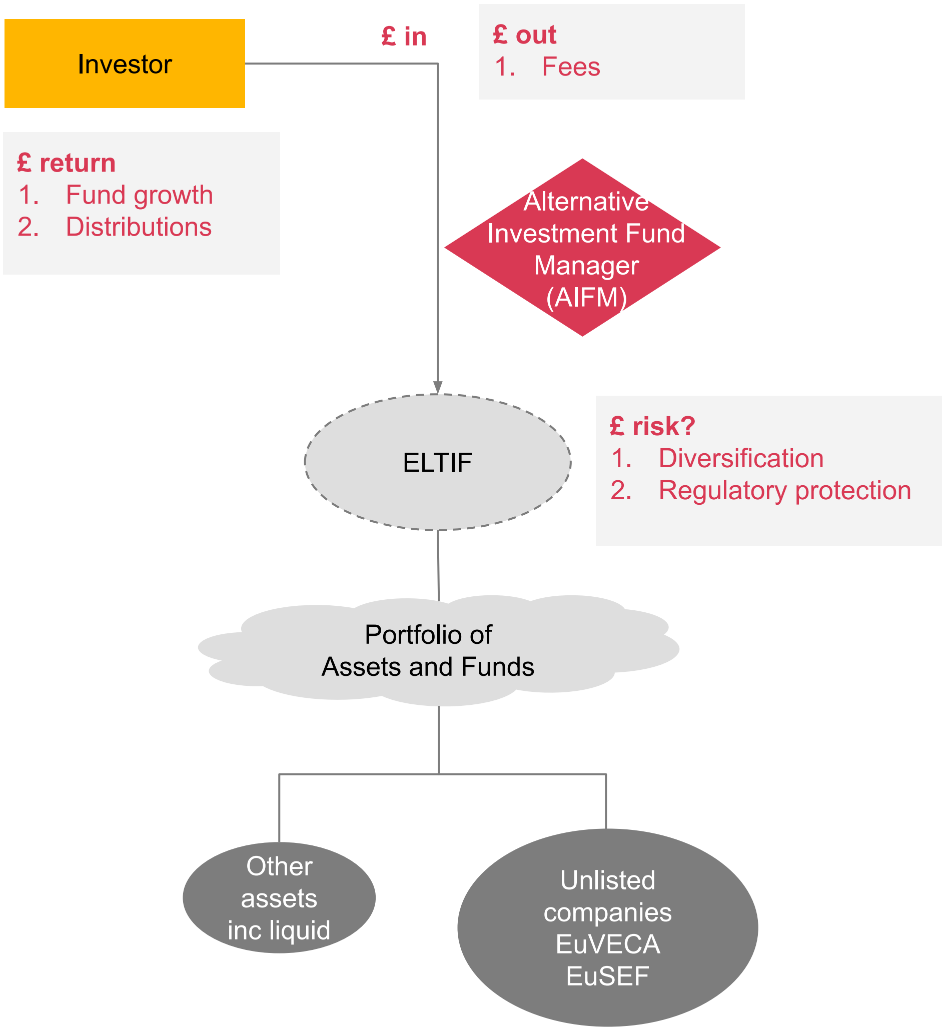
- Established in 2015, ELTIF targets institutional and certain retail investors recognising many have long-term horizons and lower liquidity needs.
- So far, the vehicle as has not been widely adopted, with operational and regulatory constraints cited as potentially limiting their appeal.
- Liquidity is more restricted than LTAFs, but a limited secondary market presents some options.

Key observations

- ELTIFs are aimed at investors who can lock up capital and accept the risks and rewards of long-term investing.
- Investors have limited influence in terms of how the fund will operate, but benefit from enhanced protection and information standards under the ELTIF regulation and the AIFMD framework.
- Funds are managed by authorised alternative investment fund managers (AIFMs), who have to comply with strict rules on portfolio composition and borrowing.
- Fee structures are similar to other alternative funds.
- They can adopt various legal forms, such as corporate, contractual, or trust-based, depending on the jurisdiction and the preferences of the AIFM and the investors.
- Generally an illiquid option, as ELTIFs cannot offer redemption rights before the end of their life, which must be at least 10 years.
- They are subject to supervision and enforcement by the national authorities of the home member state of the AIFM, and to cross-border marketing and passporting rules within the EU.

* Note that ELTIF 2.0 rules (applicable from 10 January 2024) make it possible for ELTIFs to be structured as open-ended vehicles. The “level two” Regulatory Technical Standards relating to the ELTIF 2.0 rules are yet to be adopted but it is expected open-ended ELTIFs will begin to emerge in the market by the end of 2024.

Illustration of the structure



European Long Term Investment Fund: Comparative analysis

Potential advantages and limitations across each of the assessment criteria.

	Private Capital perspective	Pension Sector perspective
Risk	• Similar to LTAFs - investment in illiquid assets and focus on growth opportunities in emerging markets may add further risk. • Regulated nature provides comfort on transparency and accountability of the alternative investment manager.	• Diversification may be limited with concentration on specific sectors, EU geographies or strategies.
Return	• Long term, returns are based on a pre-defined asset sale strategy and distributions are paid after a fixed period (typically 10 years or more). • ELTIFs benefit from preferential treatment, such as lower capital charges, tax incentives, or public guarantees, which may enhance overall returns.	• As with LTAFs, ELTIFs can be structured to generate long-term and stable returns that match the liabilities and objectives of pension schemes. • There are challenges with measuring performance and the valuation of the underlying assets, which may depend on assumptions, models, or external appraisals.
Liquidity and exit	• Illiquid assets, with long term lock-in periods and a fixed exit strategy, with generally limited or no ability to exit the fund before its term. • Any liquidity routes likely limited to secondary markets or entail significant transaction costs or discounts.	• As with LTAFs, an exit strategy is usually agreed at the outset and driven by the fund manager with less risk of conflict between stakeholders (compared to direct co-investments).
Control	• The fund manager, the eligible assets, the investment strategy and the leverage limits are subject to the requirements of the EU regulatory framework. • The decision-making process and level of investor representation can vary depending on the legal form of the ELTIF.	• ELTIFs can only be managed by authorised alternative investment fund managers (AIFMs) in compliance with EU rules. This provides some comfort over accountability.
Tax	• Tax transparent with investors taxed on their share of the fund's income and gains, rather than at the fund level.	• Tax efficient as ELTIFS are normally constructed as tax transparent vehicles when optimally structured for pensions.

European Long Term Investment Fund: Comparative analysis

Potential advantages and limitations across each of the assessment criteria.

	Private Capital perspective	Pension Sector perspective
Legal and regulation	• EU legal framework harmonises the rules and standards for the authorisation, operation, and marketing of the fund across the EU. • They can follow the form of LPFs, which limit the liability of investors.	• Potential for additional complexity based on the jurisdiction of the fund and its assets.
Fees and costs	• As with LTAFs, ELTIF managers charge fixed management fees, feature performance fees or carried interest, and an admin or operational fee. • Investors may also bear some or all of the fund's expenses, which may include due diligence, legal, audit, consulting, or transaction costs.	• Fees may be considered high, but should be looked at in the context of a fully managed service with regulatory compliance. • Regulated disclosure requirements provide some assurance over appropriateness of fees.
Communications	• EU regulation provides a framework for investors to receive regular and transparent communications.	• EU framework for reporting helps with transparency and consistency in information to members. • Focus on growth opportunities may lead to social and economic benefits (e.g. ESG-based projects) which may be attractive to members.

Perpetual Fund (PF)

The application of perpetual funds to a DC context will be difficult at present given most members will likely want to liquidate their exposure in the lead up to retirement.

Description of the structure

- An investment fund with an indefinite life and predictable returns via regular distributions.
- A PF does not have a fixed maturity date. Instead, the focus is on generating consistent income distributions for its investors, with a capital preservation strategy to maintain returns over an indefinite period.
- The duration of investment can, therefore, vary widely and will depend on the fund performance or individual investor circumstances.
- Some PFs have redemption restrictions, whereas others offer flexible exit options.

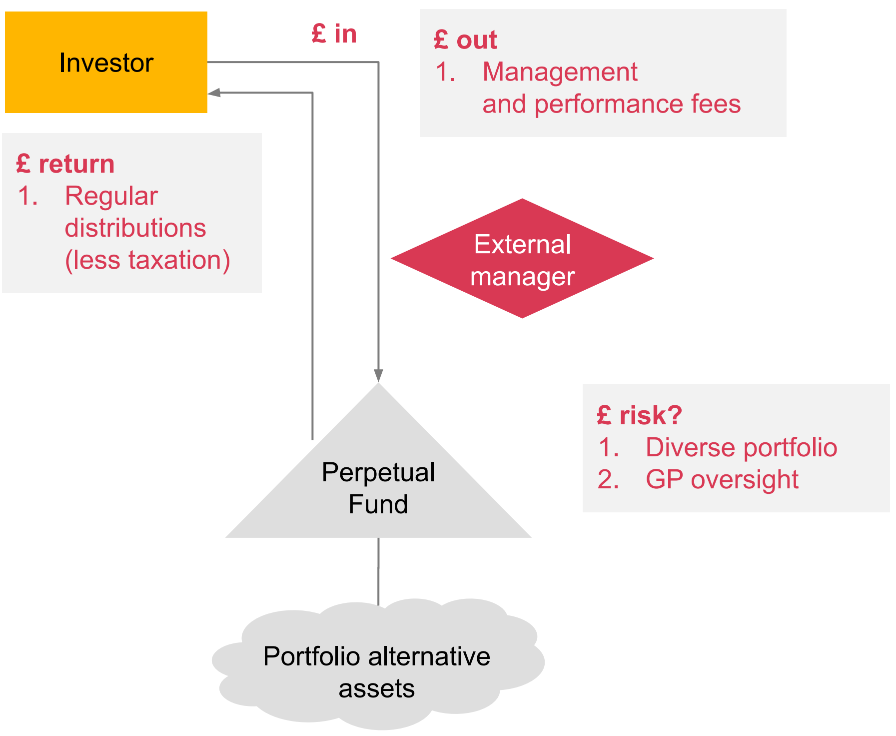
Current uses and why they are used

- Investors in PFs are primarily interested in a steady income stream on an ongoing basis with limited involvement or decision making required.
- For institutional investors, who have long-term liabilities and ongoing spending needs, PFs offer exposure to alternative assets, such as infrastructure, real estate, private equity, or renewable energy, that can generate steady cash flows, and appreciate in value over time.
- PFs may also have lower fees, more flexibility, and less volatility than traditional closed-ended funds that have fixed-term exit strategies.

Key observations

- Investors are passive with no control over the fund.
- PFs are typically managed by an external manager who has full discretion over the funds investment decisions and distributions.
- Fee structures can vary significantly between funds. Investors may also incur fees and costs when buying or selling their fund units.
- PFs can adopt a variety of legal forms and investment strategies, with regulatory oversight relevant to the jurisdiction and asset class.
- PFs are generally in the form of a limited liability structure, with exposure limited to the value invested.
- Returns are delivered through regular distributions of income and capital gains, with surplus cash flow reinvested by the fund.
- They offer limited liquidity, some funds may offer periodic redemption opportunities, while others may impose restrictions or penalties on redemptions.
- Communications with investors are generally via standardised reporting, annual statements or annual presentations on performance and outlook.

Illustration of the structure



Perpetual Funds: Comparative analysis

Potential advantages and limitations across each of the assessment criteria

	Private Capital perspective	Pension Sector perspective
Risk	• PF has lower volatility than traditional funds, but also face risks such as illiquidity, leverage, and operational complexity. • There is a heavy reliance on the expertise of the manager to maintain target income.	• Comfort to pension investors due to lower volatility if liquidity is not a concern based on the pensions scheme objectives and risk profile.
Return	• Provides stable returns over the long term, typically through a combination of dividends, interest, and capital appreciation. • They offer higher yields than traditional fixed income funds, but a lower return on exit than other alternative funds.	• Pension investors can review the fund's return objectives, performance track record, and value creation strategy to seek returns that match the liabilities and objectives of their pension schemes.
Liquidity and exit	• Limited redemption rights for investors as they are designed to hold assets. • Some liquidity options available, such as periodic windows to withdraw/transfer capital or secondary markets transactions.	• Emerging liquidity options offer some flexibility to adapt to changing circumstances or dissatisfaction with returns (subject to pricing and fees). • The application to a DC scheme could potentially be complex, but there could be a use for these types of funds in a CDC context.
Control	• GP or external manager has full discretion over the fund's investment decisions and portfolio management. • Investors have limited or no influence on investment decisions, except for certain major decisions.	• Pensions investors need to review the fund's governance structure, investor rights, reporting obligations, and conflict of interest policies.
Tax	• May benefit from tax treaties, exemptions and deferrals but may also face risks such as double taxation, withholding or changes in tax laws	• Can be structured as tax transparent and tax efficient with benefits from tax treaties and exemptions.

Perpetual Funds: Comparative analysis

Potential advantages and limitations across each of the assessment criteria

	Private Capital perspective	Pension Sector perspective
Legal and regulation	• Subject to the various legal and regulatory frameworks, as well as the laws and regulations of the jurisdictions where they invest and operate. • In a similar way to LTAFs, they may face legal risks, such as disputes or litigation arising from contractual, regulatory, or operational issues.	• As with other funds, there is potential for regulatory and legal challenges for use in the pension sector, with increased legal and monitoring costs due to lack of information and control.
Fees and costs	• Typical charging structure includes investor fees and management fees. • Fee rates and structures can differ widely depending on the specific fund, its strategy, size and terms.	• Given the wide variety of fee ranges there is likely to be a need for additional due diligence when selecting a fund to invest in.
Communications	• There will be different communication practices depending on the fund. • The fund provides information but may face confidentiality and sensitivity issues.	• Additional reporting/information needed for DC members. • Details of investment may be confidential to the fund, preventing full disclosure to pension members.

Examples of government initiatives and other structures

Long-term Investment for Technology and Science (LIFTs) initiative

- This initiative, led by the British Business Bank (BBB) looks to establish new funds or investment structures for UK institutional investment, particularly DC pension funds, to support the growth and ambitions of the UK's most innovative science and technology companies.
- The government committed up to £250m to be available to support successful proposals which considered a range of options to help unlock investment, such as a fee offset mechanism or investment on *pari passu* terms with private investors.
- In the Autumn Statement 2023 the government confirmed two successful bidders were being considered which was subject to final agreement and announcement is expected in Spring 2024.
- The Government states this will create new investment vehicles tailored to the needs of pension funds, generating over £1bn of investment from pension funds and other sources.

British Business Bank (BBB) Growth Fund

- As part of the Mansion House reforms, the Chancellor asked the BBB to explore establishing a vehicle that could receive third-party capital such as pension fund investment to invest in high growth companies.
- In the 2023 Autumn Statement the government confirmed its intention to establish a Growth Fund within the BBB. The Government highlighted that industry reaction to the initiative was positive, with eight pension providers with over £350bn AUM acknowledging that such a vehicle could be a valuable addition to the market.
- The Growth Fund will draw upon the BBB's expertise and a permanent capital base of over £7bn to give pension funds access to investment opportunities in the high growth businesses in the UK.
- The BBB will work closely with industry on the design of the investment vehicle before announcing further details.

UK Tibi scheme

- Announced as part of the Labour Party's Financing For Growth Report in January 2024.
- Modelled on the French 'Tibi' scheme, a future Labour government would set up an opt-in scheme for DC funds to invest a proportion of their assets into UK growth assets; split between venture capital, small cap growth equity, and infrastructure investment.
- An oversight committee will manage the scheme comprised of private investors responsible for drawing up an accredited list of venture capital funds and UK small cap funds, supported by British Patient Capital.
- The participating institutional investors will be asked to allocate a small proportion of their funds to the scheme and will have full discretion over which funds from the accredited list that they invest in.

'Permanent capital' structures

- Unlike a traditional limited partnership structure which invests third party capital, investors in permanent capital vehicles are shareholders who have bought shares in the investment company, so they own a percentage of the investment team and the underlying investments.
- Over a period, the investment company issues shares to raise funding, which is then invested in businesses.
- The investment company is not restricted by having to invest and return money to investors after a fixed period, which reduces pressure to deploy funding in the early years and facilitates longer holding periods - which may enable capture of more upside on investments, particularly where investments are made early in the growth cycle of a business.
- These vehicles are sometimes used by venture capital firms that invest in university spinouts, and there are various examples already in the market.

Examples of government initiatives and other new structures

Listed private capital investment trusts

- This is a type of permanent capital vehicle that instead of drawing down from investors as portfolio company investments are identified, raises initial capital by selling a fixed number of shares in a vehicle making underlying portfolio investments in private markets assets. Compared to unlisted permanent capital vehicles, this means that investors are shareholders who then own a percentage of the vehicle and, indirectly, its underlying investments. The key difference between listed investment trusts and other permanent capital vehicles is that the vehicle is listed on an exchange and its shares are publicly traded.
- Listed private capital investment trusts are a relatively well-established route for both retail and institutional investors to gain exposure to private capital investments, and there are a number of examples in the UK market.
- The advantages of this vehicle include that it offers investors immediate, diversified exposure to private capital assets and provides liquidity through listing on an exchange, without the extra complications and cost of managing open-ended vehicles (such as managing in-flows and redemptions).
- The chief disadvantage in practice from an investor perspective is that shares in private capital investment trusts sometimes trade at a discount to the NAV of the trust's assets.

Appendices

08

Glossary

Our report includes a number of terms and short descriptions, which we define alongside

Term	Definition
ACS	Authorised contractual scheme
AF	Authorised Fund
AFM	Authorised Fund manager
AFV	Authorised Fund Vehicles
AIF	Authorised Investments Funds or Alternative Investment Fund
AIFM	Authorised Investments Fund Manager
AMC	Annual management charges
AUM	Assets Under Management
AUTs	Authorised Unit Trusts
BBB	British Business Bank
BVCA	British Private Equity & Venture Capital Association
CDC	Collective defined contribution
DB	Defined Benefit
DC	Defined Contribution
DWP	Department for Work and Pensions
ELTIF	European Long Term Investment fund
ESG	Environmental, social, and corporate governance
Expert Panel	Pensions & Private Capital Expert Panel
FCA	Financial Conduct Authority
FoF	Fund of Funds
GB	Global buyout
GE	Growth Equity
GPP	Group Personal Pension
GP	General Partner

Term	Definition
Investment Compact	Investment Compact for Venture Capital & Growth Equity
IGCs	Independent Governance Committees
LGPS	Local Government Pension Scheme
LIFT	Long-term Investment for Technology and Science
LP	Limited Partner
LPF	Limited Partnership Fund
LTAF	Long Term Asset Fund
NAV	Net Asset Value
OEICs	Open-Ended Investment Companies
PC	Private Capital firms
PCM	Private Capital Manager
PE	Private Equity
PF	Perpetual Fund
PLSA	Pensions and Lifetime Savings Association
PPI	Pensions Policy Institute
PRA	Prudential Regulatory Authority
QIS	Qualified Investor Schemes
SIPP	Self-invested Personal Pensions
SMA	Separate Managed Account
TEG	Technical Expert Group
TPR	The Pensions Regulator
UCITS	Undertakings for Collective Investment in Transferable Securities funds
VC	Venture Capital
VFM	Value for Money

Thank you

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