Invested in a better future

Pensions & Private Capital Expert Panel

Final Report

April 2025

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Foreword

I was asked to chair the Expert Panel, tasked with finding solutions to enable UK DC pensions to invest more of their assets into private capital funds and unlisted growth equity. This final report builds on the Expert Panel's interim report of September 2024 and provides recommendations to drive significant investment into high growth innovative companies benefitting the UK's growth ambitions, and providing UK pension savers access to greater returns upon retirement.

Over the last 12 months, the Expert Panel has identified the barriers, prioritised workstreams and worked alongside the ABI, BVCA and PLSA and with the Technical Expert Group of 100 industry experts to fully understand the detail. We found consensus, and have been able to make recommendations for government, regulators and industry.

As I reflect on the last year, I am proud to report that progress is being made. There are regular reports of pension funds increasingly making new private capital commitments and building up expertise within their teams, and more LTAFs being launched. The Government has repeatedly stated it remains committed to improving both the returns for savers' retirement pots, and the opportunities for successful businesses to grow here in the UK. As a venture capitalist for 25 years and founding partner of a venture capital firm, I also see firsthand how venture capital and growth equity investment continues to support outstanding companies and generate outperforming returns.

This has been a complex undertaking and the commitment of the pension and private capital sectors to work together through the Expert Panel to find solutions has been notable. BVCA data shows that, across all types of pensions, 16 times more capital from pensions around the world goes into UK private capital funds than from British pension funds. The PLSA estimated that only 35% of households saving into a DC pension will meet the 'moderate' level of retirement income as set out in the Retirement Living Standards. At the last formal stock take, carried out by the ABI in the summer of 2024, just 0.36% of the default funds of Mansion House Compact signatories were invested in unlisted equity assets. There is strong reason to hope that the figure will have increased by the time of the next stock take.

For me, the real value over the last year has been the opportunity to convene so many experts together for the first time in the same room and learn more about each other's constraints and ambitions. There is no overnight solution, nor a magic button to unlock the funds, and we must continue to work together to achieve the target.

The coming months will bring many more developments in this space, most notably the Pension Schemes Bill, in which the Government plans to implement new consolidation requirements for DC pensions. Alongside these changes, there are a series of interconnected measures outlined within this final report which, if adopted, will provide more opportunities for DC to invest into private capital.

There remains a huge amount of work to do - by both the private capital and pensions industries as well as by the Government and regulators. We need the momentum to continue so that we can achieve this collective ambition.

Kerry Baldwin
Managing Partner, IQ Capital (Chair)

Acknowledgements

I would like to reiterate my thanks to everyone who has been involved in this project over the past year. The members of the Expert Panel and Technical Expert Group have been especially generous with their time and knowledge, and this has enabled us to cover a wider range of issues extensively.

A particular note of thanks to PwC, who produced the first report of the panel in early 2024, and who have been on hand to share their expertise throughout; to Elena Zhmurova of Altconsult for her assistance in gathering and assessing valuable market insights on fees; and to our colleagues at the PLSA and ABI, who have been very supportive and have worked closely with the Panel and with the BVCA throughout.

I would also like to note my thanks to our stakeholders in government and at the regulators, mainly the DWP, HM Treasury, DBT, DSIT, TPR and FCA, who have continued to keep in touch with us and have shown a clear willingness to consider the recommendations and issues raised by the panel.

Finally, I'd once again like to note my thanks to the team at the BVCA, who have convened stakeholders from across the pensions and private capital industries to develop solutions to the key challenges over the course of a number of years.

Pensions & Private Capital Expert Panel


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Executive summary

Since its formation, the Expert Panel has convened regularly to monitor progress, consider market developments and to identify the best ways to address barriers for UK DC schemes to invest into private capital. This final report sets out the recommendations and key findings of the Pensions and Private Capital Expert Panel. This work builds on the Expert Panel's interim report, published in September 2024. As highlighted in that report[1], the UK's world-leading private capital fund industry offers a huge opportunity for UK DC pension savers to benefit from greater investment in the country's innovative growth companies.

Phase 1: Interim report

The interim report showcased extensive evidence and data on the private capital industry's track record of delivering strong risk-adjusted net returns and portfolio diversification benefits, as companies stay private for longer[2]. It also described how private capital supports innovative companies across a diverse range of growth sectors around the UK, and the benefits this brings for profitability, productivity and UK growth as a whole. The interim report set out 12 recommendations for industry, regulators and policymakers.

The Expert Panel established at an early stage the key themes that needed to be addressed: the investment case & transparency; market infrastructure; liquidity; and evolution of the wider pensions market. These were covered in the Expert Panel's interim report:

The Investment case & transparency

The Expert Panel recognised the need to build mutual understanding across the pensions and private capital industries. This would build confidence among DC decision-makers in the benefits of investing in private capital funds, for pension savers and for UK economic growth. It was evident that the value for pension schemes of investing in private capital funds needed to be highlighted. Therefore, the Expert Panel recommended that:

- The pensions industry should be empowered by Government and regulators to move away from short-term cost considerations, to long-term returns by DC pensions.
- Consistent cost disclosure requirements should be applied across the investment ecosystem.
- Platforms and advisers should use quarterly private capital valuations, alongside appropriate governance for unusual liquidity events, to ensure fairness between members in unit pricing.
- The private capital and pensions industries should work together to develop a model Request for Proposal.
- All parties should consider in detail how far new and alternative approaches to fee structures might be made to work in savers' interests.
- As the Government explores the creation of new vehicles or schemes to facilitate pensions investment in high growth companies, it should draw lessons from domestic and overseas precedents, including the French Tibi scheme.

[1] Expert Panel interim report (page 21/22: the investment case)
[2] BVCA paper on academic evidence around private capital fund returns, risk and diversification

Executive summary

Market infrastructure

Long Term Asset Funds (LTAFs) and life insurance platforms were identified by the Expert Panel as two key features of the current market infrastructure that facilitate investment for DC schemes. However, it was acknowledged that there remain challenges in using life platforms for investing in private capital and that more LTAFs should be encouraged to come to market. The Expert Panel recommended that:

- The FCA should make targeted changes to the relevant regulations so that investor access is not unduly restricted and to encourage more LTAFs to come to market.
- The FCA should review and amend the 'permitted links' rules for unit-linked life insurance platforms.
- Life insurance platform providers should look to expand private capital options for DC schemes.

Liquidity

The Expert Panel recognised that liquidity management was an important consideration for any investor allocating to illiquid private capital funds. UK DC schemes have particular considerations in relation to liquidity management, which the Expert Panel considered in detail. This was an area of focus for the Productive Finance Working Group which produced a guide to liquidity management at a scheme and underlying fund level. Despite this, concerns over liquidity management in the event of a one-off liquidity event or bulk-transfer, though rare, may act as a disincentive for DC pension schemes to invest in private capital funds. Therefore, the Expert Panel recommended that:

- Regulators should work with industry to provide reassurance, and updated guidance, on their liquidity expectations for how DC schemes should handle stress events and their impact on liquidity.

Wider pensions market

The Expert Panel reflected on the evolution of the pensions market, including the regulatory environment and the ability of pensions schemes to invest in long term, illiquid investments, such as private capital. The interim report reflected on the importance of a focus on long term net returns for members, as the market and regulation changes. The Expert Panel recommended that:

- DC schemes should consider the role of 'to and through' investing, with a view to keeping savers invested in private capital investments for longer periods of time.
- Industry and Government should work together to consider how risk can be better pooled in DC structures in the interests of savers. In particular, CDC schemes should continue to be explored.

Phase 2: The Final Report

In a number of cases, the recommendations described above have already been taken forward at least in part. However, there is still more to do. Following the publication of the interim report, the 12 recommendations provided the Expert Panel with the foundation for its final report. Their work was also informed by a new and evolving policy context following the Chancellor of the Exchequer's Mansion House Speech in 2024. This final report provides an assessment of how these recommendations have evolved and gives detailed further consideration to several of them.

The key recommendations outlined in this report fall under three overarching themes: policy interventions; facilitating investment; and industry collaboration. The final report summarises progress made, comments on key market developments and makes more detailed recommendations for industry and policy makers to consider.

Executive summary

Policy interventions:

- **Investment marketplace:** the Expert Panel seeks Government support for a new programme to encourage and accelerate DC investment in UK venture and growth capital funds, including:
  - **i.** The creation of 'NOVA' (New Opportunities for Venture and growth Acceleration), an initiative modelled on France's successful Tibi Scheme, to create a market of private capital funds specially accredited for DC schemes to facilitate investment in strategically important sectors.
  - **ii.** A new fund of funds investment vehicle, to build on the British Business Bank's (BBB) British Growth Partnership, which will enable pensions access to returns generated by smaller private capital funds.
  - **iii.** An industry-approved private capital directory, containing the key facts and information about specific private capital firms and funds which will act as a 'shop window' to accelerate investment. The Expert Panel urges the Government to consider direct support for this programme as part of the ongoing spending review.
- **Removing regulatory barriers:** the Expert Panel seeks progress in the implementation of the Value for Money framework; the reform of the 'permitted links' rules; and a review of the DC charge cap guidance. It also encourages an eventual review of the LTAF rules, to ensure the framework is sufficient to encourage more and larger LTAFs in the market.
- **Exploring opportunities to pool risk:** the Expert Panel believes that alternative models to enable risk pooling, such as Collective Defined Contribution, could provide an important role and urges the Government to ensure its plan to consolidate the sector does not inadvertently restrict this.

Facilitating investment:

- **Further industry guidance:** the Expert Panel has established guidance for commercial discussions in the context of Requests for Proposals and Fund Due Diligence Questionnaires, which it recommends for wider cross-industry discussions.
- **De-mystifying fees and enabling constructive engagement:** the Expert Panel offers insights into private capital fees and DC, including commentary on challenges and progress on solutions and a dedicated explainer (Annex 2).
- **Established international practice:** the Expert Panel draws lessons from Australian DC experiences of investing in private capital funds.

Industry collaboration:

- **Continuing the momentum of cross-industry engagement:** The Expert Panel has demonstrated the value of collaboration, and recognises that it is of utmost importance to maintain this going forward, as new market practices develop and the legislative and regulatory environment change. The Expert Panel will therefore evolve to maintain industry engagement and collaboration, through a new forum developed through further engagement across both industries.

The recommendations are set out below in full. These provide industry and policymakers with clear recommendations to facilitate substantive progress to achieve the objectives of improving the retirement prospects of UK pension savers and increasing investment from UK DC pension schemes into UK private capital funds. Through the work of the Expert Panel, there has been significant progress in building mutual understanding across both the pensions and private capital industries, demonstrating how industry and policymakers can work together to achieve a stronger, more effective partnership. This collective effort will help support both industries to achieve their respective commitments in the Investment Compact and the Mansion House Compact.

Recommendations

The Expert Panel makes the following recommendations:

Policy interventions

- The Government should introduce a new programme to accelerate DC investment in UK venture and growth capital funds, consisting of a private capital fund directory, a NOVA scheme emulating France's Tibi scheme, and an ambitious fund-of-funds programme.
- The Government should progress with implementation of a Value for Money framework, and provide clarity on how it will interact with other policy initiatives.
- The FCA and TPR should act to ensure that the Value for Money framework does not make short-term investments a mandatory consideration for schemes serving long-term DC savers.
- The Government should revise its guidance on the application of the DC charge cap, to ensure that costs are disclosed in a comparable manner across both public and private market investments.
- The FCA should carry out a formal post-implementation review of the LTAF framework, once a greater number of LTAFs have come to market.
- Regulators should ensure that DC schemes have clear expectations around liquidity as the landscape evolves.
- The FCA should ensure the 'permitted links' rules are amended as soon as possible to widen private capital investment options for DC default schemes that use life insurance platforms.
- The Government should continue to consider how CDC, and any other risk pooling models, can continue to develop as the DC landscape evolves over the coming years.

Recommendations

The Expert Panel makes the following recommendations:

Facilitating investment

- Private capital firms, DC schemes, trustees and advisers should consider the Expert Panel's "Guidance for the RFP process" (see Annex 1), to inform commercial discussions about DC default investments in private capital funds.
- DC schemes, private capital firms and their advisers should consider the market insights on fee innovations set out in this report.
- UK DC schemes should consider lessons from the experience of Australian DC schemes, especially around: (i) the operational integration of carried interest/performance fees; (ii) building private capital teams; and (iii) balancing fund investments with co-investments.
- Life insurance platforms should continue the positive trend of innovation in developing private capital solutions for DC schemes.
- DC schemes to continue to implement strategies that will ensure savers are invested in growth assets both to and through their retirement.
- UK DC schemes, platforms and advisers should continue integrating quarterly private capital valuations into member unit pricing.

Industry collaboration

- Cross-industry engagement generated by the Expert Panel will continue as new market practices develop and the legislative and regulatory environment change. Through further engagement across both industries, the Expert Panel will evolve to maintain industry engagement and collaboration, through a new forum.

Public policy and market context

Since the Expert Panel published its interim report in September 2024, there has been continued and substantial momentum from the Government to reform pensions investment.

The Government's pensions review has had significant focus on scale, and continued emphasis on the need to diversify and shift the balance of investments made by UK DC pension schemes so that they can access the investment opportunities and returns that international funds do. Overseas pension savers are benefiting from this growth and investment performance – BVCA data shows that non-UK pension schemes are investing 16 times more in UK private capital funds than UK pensions do. The Government intends to publish findings from the pensions investment review in the spring and implement reforms through the Pension Schemes Bill later in 2025.

The Chancellor of the Exchequer outlined her vision in November 2024 during her Mansion House Speech to introduce "megafunds" through pooling Local Government Pension Schemes and consolidating DC schemes, with the proposal to introduce a new minimum level of assets under management for DC default providers. The threshold of £25 billion has been consulted on, with the aim to ensure that more DC pension schemes invest in UK start-ups, scale-ups and UK infrastructure.

The Expert Panel and this report do not focus specifically on the impact of consolidation and there is a range of views across industries on the specifics of the Government's proposals and the exact impacts of minimum AUM thresholds, in particular. However, it is worth noting that generally, there is recognition that scale will help DC schemes to make private capital investments.

The Expert Panel has observed increasing activity in the market. There are a number of new vehicles in use; increasing commitments for DC investment into private capital, growth and infrastructure; and a change in language and tone in discussing investment into private capital. It is clear that there has been a change in how these matters are approached already, and the Expert Panel encourages DC schemes to continue this work.

However, despite this positive market activity to-date, the momentum from government and the forthcoming legislation, it is likely that the reforms will take some time to implement and take effect in full. As yet, there has not been a significant increase in DC default fund investment into private capital funds. There is also more to be done to ensure that DC schemes have the right conditions, support and capabilities to ensure the right investments. This is essential so that UK businesses can benefit from investment; but also crucially so that the pension pots of UK savers can be improved. With this in mind, it remains of utmost importance that stakeholders from across the pensions and private capital industries continue to work collaboratively so that we can, alongside government, ensure this can be achieved, boosting UK growth and retirement outcomes.

Timeline of activity

- **April 2016** – Patient Capital Review
- **Nov 2020** – Productive Finance Working Group announced
- **Sept 2021** – Productive Finance Working Group Report published; First Value for Money Discussion Paper
- **Nov 2021** – LTAF rules take effect
- **Apr 2023** – DC charge cap rules change
- **Jul 2023** – Mansion House Compact signed
- **Oct 2023** – Investment Compact signed
- **Feb 2024** – Expert Panel convened
- **Jul 2024** – Pension Investment Review Launched
- **Sep 2024** – Expert Panel Interim Report
- **Nov 2024** – Chancellor sets out pension reform plan

Summary of market successes and survey data

The UK's world-leading private capital fund industry offers a huge opportunity for UK DC pension savers to benefit from the returns and diversification benefits of greater investment in the country's innovative growth companies.[3] This section summarises some of the progress industry has made in seizing that opportunity over the last year.

As part of the commitments set out in the Investment Compact for Venture Capital and Growth Equity, the BVCA committed to report on progress from Investment Compact signatories in attracting UK pensions capital into the funds they manage. This complemented the monitoring of progress made by Mansion House Compact signatories to their own commitments to allocate 5% to unlisted equities by 2030.

Since the launch of both Compact initiatives, there has been significant market activity to achieve the shared objective of increasing investment from UK DC pension schemes into UK private markets, in particular, private capital funds that support high-growth, innovative UK companies.

Over 100 venture capital and growth equity firms are now signatories to the Investment Compact, demonstrating the commitment from the private capital industry to this agenda. As part of the BVCA's commitments, it launched the Investment Compact signatory survey in 2024 to provide a holistic assessment of the current engagement from the perspective of signatories on current market engagement. Preliminary findings published in September 2024 found that over 50% of respondents were actively contacting Mansion House Compact signatories, marking positive progress since the launch of both Compact initiatives in 2023.

The BVCA re-launched the signatory survey to continue to assess progress, engagement and current market activity. As of March 2025, over 60% of respondents are now actively contacting Mansion House Compact signatories. This is a welcome sign that progress continues across both industries to increase investment. The BVCA also collated views on what Investment Compact signatories feel could be introduced to support investment beyond what currently exists in the market. 42% of respondents would participate in a new fund of funds that has a broader remit than the BBB and is underpinned by Government financial commitment should that be introduced.

In July 2024, the ABI published an update to mark the first anniversary of the Mansion House Compact. This showed that £793 million of unlisted equity assets were held in the default funds of signatories, representing 0.36% of investments. The ABI aims to publish a further update on this in summer 2025, two years on from the original Compact. Though it is too soon to assess whether this figure will have increased, there is certainly evidence that DC schemes and providers are taking steps to diversify their default funds into illiquid assets. In recent months, for example, there has been significant interest in Long Term Asset Funds (LTAFs), with a number of new launchesthat should help meet the commitments made in the Compact. Carne Group research suggests that 82% of UK asset managers are considering a LTAF launch. Many industry commentators also expect that the continued integration of illiquid investments such as private capital will be a focus throughout 2025.

The commitment from across both industries is a welcome step forward and supports the Government's objective of delivering UK economic growth. There remains significant progress to be made in terms of deployment, and continued engagement from both industries and Government will help achieve this.

[3] BVCA paper on academic evidence around private capital fund returns, risk and diversification

Investment Compact signatory survey

Over 60%

of respondents are actively contacting Mansion House signatories or other DC schemes

34%

of respondents expect commitments from Mansion House Compact signatories in 2025

Examples of progress: Increasing DC pensions investment into private capital

Future Planet Capital strengthens its partnership with NatWest Cushon

FUTURE PLANET CAPITAL

The relationship between Future Planet Capital, the impact-led venture capital firm, and workplace pensions and savings provider NatWest Cushon goes from strength to strength. In November 2024, the two parties started their collaboration with a view to the Cushon Master Trust potentially making an investment in the British Co-Investment Fund (BCF). The BCF's tailored structure and fee mechanisms will allow pension scheme managers to allocate capital to UK venture investment with the potential for generating higher long-term returns for savers.

Subject to commercial terms and trustee agreement, NatWest Cushon's participation would signify a major step forward in creating new avenues for British pension funds to access high-growth, private technology companies at scale. It will deliver one of the few routes for corporate, Local Government and Defined Contribution Pension Schemes to support some of the UK's most significant fast-growing, privately held businesses, in a direct response to government calls to unlock pension capital to invest in UK private markets.

Building on this partnership is more important than ever. The UK faces a generational challenge in allocating pension fund investment toward start-ups and technologies of the future. If the industry is to meet it, we need more ambitious collaborations like these. We at Future Planet Capital look forward to working closely with NatWest Cushon in the coming months.

Commenting on the launch of the BCF, Future Planet Capital's Executive Chairman and Founder, Douglas Hansen-Luke, said:

"The British Co-Investment Fund is a much-needed solution to support pension managers in meeting the objectives of the Mansion House Compact whilst also helping British pension savers benefit from the opportunities presented by the UK's most exciting private companies. Future Planet Capital already works with the country's top universities and research centres, to invest in some of the UK's most promising impact-led business. By democratising access to venture investments for pension savers, we can channel further capital into these businesses, and ensure the UK remains at the forefront of global innovation."

Independent strategist Julius Pursaill, who is an advisor to organisations including the Cushon Master Trust, said:

"There are a number of good reasons to support the UK Growth agenda and innovations like the British Co-Investment Fund play an important role in delivering on this objective, driving financial growth, whilst also offering access to innovative, impact-focused sectors such as climate technology and artificial intelligence, which can help secure the future for pension savers and broader society."

Examples of progress: Increasing DC pensions investment into private capital

Cambridge Innovation Capital agrees partnership with Aviva Investors

Aviva Investors has invested £15 million in Cambridge Innovation Capital's (CIC) Opportunity Fund. This newly launched fund targets growth stage rounds of deep tech and life science companies, providing capital to the next generation of domestic champions. By working together, CIC and Aviva Investors are providing finance to support the UK's maturing innovation ecosystem, addressing the gap in scale-up funding in the UK, while aligning with the UK Government's plans to deliver the Oxford-Cambridge Growth Corridor and encourage more investment into unlisted equities.

Andrew Williamson, Managing Partner at Cambridge Innovation Capital, added:

"CIC has traditionally invested in early-stage opportunities around Cambridge and has seen many of these companies mature into highly commercial businesses developing proven technologies. With this new Fund we will support our portfolio companies, and scaleups from the UK ecosystem, as they reach a defining moment in their growth – and at exactly the point where the UK often loses its most exciting businesses. We want to be a part of that change, and we're delighted to be working with Aviva Investors to achieve this ambition."

Ben Luckett, Managing Director, Venture and Strategic Capital, at Aviva Investors, said:

"We are very pleased to complete our latest investment in the Cambridge innovation cluster. CIC has a wealth of expertise in life sciences and deep tech, discovering and supporting pioneering companies like Pragmatic and Riverlane which can help the UK get ready for the future whilst putting it at the forefront of global innovation."

"As an investor with a long-standing presence in Cambridge, we understand its reputation as a world-leading technology cluster, the huge value of the unique ideas being created here, and their potential to create growth, success and impact. We believe CIC's new Fund and its unrivalled access to these early-stage companies, will enable us to support their growth whilst aiming to deliver long-term investment outcomes."

Key features of a Government programme to accelerate DC investment in UK private capital

The Expert Panel's interim report recommended that as the Government explores the creation of new vehicles or schemes to facilitate pensions investment in high growth companies, it should draw learnings from domestic and overseas precedents (including the French Tibi scheme). The interim report explored the design features of several domestic and overseas initiatives that have facilitated pensions investment in high growth companies, including the French Tibi scheme which has secured c.€20bn of investment from French institutional investors into private capital funds investing in the French tech ecosystem.

Since the publication of the interim report, the British Business Bank (BBB) has formally launched the British Growth Partnership (BGP), which the Expert Panel considers a positive step to encourage DC investment in innovative UK companies. The Government has also continued to drive DC consolidation and LGPS pooling, emphasising the importance of scale to enable more diversification and investment into private capital.

However, it is generally recognised that it will take time to see markedly increased investment. Aside from themes discussed elsewhere in this report, there remain two broad issues that could limit the speed of progress:

(i) Limited expertise, knowledge and information on private capital fund managers for DC providers.

(ii) Ability to make investments at the right "ticket size" to access the returns generated by smaller investments into private capital funds.

The Government should help to address these issues through its convening power and through direct financial commitments. If done effectively, this could help achieve existing industry commitments, drive growth in the UK, achieve returns for savers, and address the scale-up gap in the UK (estimated at between £15bn - £24bn). This funding gap helps drive UK tech and other innovative and growth companies to seek scale-up capital from overseas investors or indeed relocate when they reach series B stage of their development for the next stage of growth.

Key features of a Government programme to accelerate DC investment in UK private capital

Key elements of a Government programme

The Expert Panel recommends that the Government considers the introduction of a programme based on the following options to encourage investment from UK pension schemes into UK private capital funds. This programme could facilitate information flows and investment, while maintaining and encouraging an active and competitive market:

1. Private capital directory, acting as a 'shop window' to accelerate investment

A directory containing key facts and information on specific private capital firms/funds should be established and made available to UK DC schemes (note that the regulatory implications of including details of specific, open funds[4], would need to be considered). This would create a 'shop window' for DC schemes that would facilitate desk-based research and act as a springboard for introductions. This would help build the DC and private capital industries' understanding and familiarity with each other, accelerate commercial discussions and investment, and can help explore opportunities according to their own illiquid investment priorities. A directory could also be help explore opportunities within the perimeter of Government's investment priorities.

The information provided on private capital funds would go beyond the existing information provided by the BBB and the BVCA to include commercial and technical details, covering sector, stage and investment strategy. Government support to establish a directory of this kind would signal a commitment to increase engagement between both industries further. This could be led by the BBB, industry, or the Government itself, and could be designed to drive forward the Government's priorities e.g. the Industrial Strategy sectors.

2. NOVA Scheme - a UK scheme, incorporating a gatekeeper/marketplace for qualifying funds

Senior Government leadership (e.g. the Prime Minister or Chancellor) should drive the introduction of a "NOVA" scheme (New Opportunities for Venture and growth Acceleration), emulating the French Tibi scheme, which has secured c.€20bn of investment from French institutional investors to private capital funds investing in the French tech ecosystem. This would create a marketplace of accredited private capital funds for DC schemes, to facilitate investment, potentially focused on strategic sectors. A partnership between industry experts, the BBB, or other appropriate Government department or subsidiary, could act as the gatekeeper of a certified accreditation process.

The criteria for the French Tibi scheme formed a flexible framework for identifying French funds investing in the tech ecosystem. The NOVA scheme would have criteria around investment strategy, track record and experience with institutional investors. Fund terms and structures could also be required to fall within agreed ranges on areas like reporting, valuations and potentially other terms designed to mitigate DC-specific challenges. This could allow participating DC schemes to compare private capital fund opportunities from a pre-filtered pool and engage bi-laterally with those firms to discuss terms, structures etc. in more detail.

The gatekeeper/accreditation process, led by an appropriate Government department, would act as a qualifying kitemark for funds to participate in a NOVA scheme, with additional criteria relating to sector focus identified by Government. This could include the BBB and would likely need specific commitments from participating UK DC schemes to invest agreed amounts into funds on an extended list of 'accredited' private capital funds.

[4] 'Open funds' in this context means closed-ended funds that still open for new investor commitments i.e. during their fundraising period.

Key features of a Government programme to accelerate DC investment in UK private capital

A UK scheme could be broadened to include LGPS schemes and other institutional investors, with the core investment objectives linked to the key sectors identified in the Government's Industrial Strategy. The Government could set an initial target of several billion pounds, with a more ambitious longer-term target that scales as the scheme develops, in a similar way to the French Tibi scheme. This would reflect the amount of capital required to address the need (e.g. the scale-up gap) but over time, in a realistic, sustainable and strategic way.

3. A new fund-of-funds programme building on the BGP

The BBB's British Growth Partnership (BGP) is a positive step in driving innovation through leveraging long-standing private capital markets investment experience, developing new and existing relationships and carrying out commercial product testing, all of which are needed for the UK market to learn how to invest UK pensions into private capital effectively and at scale. It is critical that the BBB is able to continue to develop a series of further initiatives to build on the BGP, including a fund-of-funds vehicle to enable investments at the right "ticket size" in order to access and benefit from returns generated by investments into smaller private capital funds.

This will expand the BBB's current investment strategy beyond late-stage venture co-investments which, relative to fund investments, offer only limited investment in the business growth ecosystem, a smaller opportunity for deployment, unclear track record and more limited diversification.

A new fund-of-funds programme should focus on growing the UK's venture and growth capital investment ecosystem, by supporting growth equity and growth capital funds, and expand the BGP's target of "hundreds of millions" to at least £1bn of commitments. This target would be a positive starting point (with the opportunity to grow and expand into a series of vehicles as the programme develops). It could be built around a £300m government cornerstone investment to crowd in an additional £700m of investment from UK pensions (DC, DB and LGPS). The total £1bn could be split between strategies (late stage venture and growth capital).

The Government should consider various levers that might help crowd in UK pensions investors, as well as a cornerstone investment to provide confidence. This could include Enterprise Capital Fund-style terms that would leave more of the upside for other LPs, or a fee offset mechanism to mitigate LGPS concerns around extra fees on top of pool expenses. The first fund of funds would look to close within one year and return to market within two-to-three years, providing evolution through 'vintages'.

Recommendation

The Expert Panel recommends that the Government introduces a new programme to accelerate DC investment in UK venture and growth capital funds, consisting of a private capital fund directory, a NOVA scheme emulating France's Tibi scheme, and an ambitious fund-of-funds programme.

Guidance for the Request for Proposals process

In its interim report, the Expert Panel recommended that the private capital and pensions industries should work together to develop a model Request for Proposal (RfP).

The BVCA formed a working group to look at what was already in use and consider how the group could add value to the process. It was clear that there were several other templates in use, including the Institutional Limited Partners Association (ILPA)'s Due Diligence Questionnaire. From gathering examples of what private capital firms typically received, it was clear that each scheme has its own specific requirements.

The working group did not consider that it would add value to the process to attempt to standardise this process. However, it is clear that there are some features of private capital investments which do not fit into the standard pension RfP process, and that this often left both parties unclear on what to ask or how to reply.

The Expert Panel has therefore published, at Annex 1 of this report, some informal guidance on key areas that it recommends pension schemes and private capital fund managers discuss as part of the RfP process. The guidance is aimed at both parties and describes the overall structures in place, as well as setting out some familiar terms used in private capital in relation to costs and other topics.

It covers areas where there is often a mismatch in expectations or awareness and emphasises the importance of discussing topics such as: 'permitted links' constraints, reporting requirements, existing fund arrangements and valuation frequencies at the outset. It also notes the importance of discussing and agreeing alignment of interests and investment beliefs.

The guidance does not seek to be an exhaustive list and it does not seek to advise on what terms 'should' be in place – the Expert Panel recognises the market should determine these matters, and that these may differ from case to case. However, it hopes that the new guidance will provide insight into how to approach such discussions, and that both parties will feel better equipped. The guidance is published in Annex 1 and will be made available on the BVCA's website.

Recommendation

The Expert Panel recommends that Private capital firms, DC schemes, trustees and advisers consider the guidance at Annex 1 to inform commercial discussions about DC default investments in private capital funds.

Fees: market insights on challenges and progress

The Expert Panel's interim report recommended that the pensions and private capital industries "consider in detail how far new and alternative approaches to fee structures might be made to work in savers' interests". The Expert Panel has since fostered further discussions and gathered further insights from a dedicated technical working group and over 20 targeted interviews with UK DC master trusts and private capital firms.

Perceived challenges and how industry is addressing them

The UK DC industry has historically not invested in private capital funds using the global "2 & 20" model (2% ongoing management fee, plus 20% carried interest) or variations of it (explained further in Annex 2). However, the industry is evolving and there are some interesting and innovative market practices and potential solutions to traditional challenges. The key challenges and potential emerging market solutions and innovations that the Expert Panel discussions have focused on are summarised here:

1. Total expense considerations

DC master trusts' average Total Expense Ratio[5] ("TER") has converged under market pressure to around 0.3% in recent years, considerably below the 0.75% charge cap. Private capital funds' (typically) 1.5-2.5% management fee based on a scheme's commitment[6] is particularly challenging for commercial master trusts, for which even a small difference of a couple of basis points might determine whether they are selected by employers to deliver a mandate. Some trustees view the 2 & 20 model as a significant deviation from the single digits paid for passive index funds. There are also queries about how carried interest arising from the strong performance of some funds within a private capital programme would be presented in a situation where the programme overall underperformed. Nevertheless, master trusts are actively working on integrating private capital fund investments with carried interest or a performance fee into their portfolio using a variety of approaches, from bespoke fee structures to co-investments.

"The commercial reality is such that the total fees are not important for us, but the TER is, which excludes performance fees. That means we won't pay a 2% management fee, but we'll pay a higher performance fee, potentially more than 20%" – a commercial master trustbut we'll pay a higher performance fee, potentially more than 20%."

– a commercial master trust

[5] A TER in DC defaults is a measure of the total costs of running a scheme; it includes all investment and administrative costs but excludes transaction costs and performance fees.

[6] Private capital fund fees are typically charged on the amount an investor has committed to make available to the fund (rather than the amount that has been invested at any point). This is called a "capital commitment" and is explained further in Annex 2.

Fees: market insights on challenges and progress

Current market activity around solutions and innovations:

- **Alternative fee structures and/or separate investor classes.** Several master trusts are exploring alternative fee structures, such as lower management fee/ higher carried interest. It is important to consider the potential trade-offs and long-term alignment of interest considerations here. Equally, too low a management fee may pose challenges for execution, particularly for less mature private capital firms (see Annex 2 for more details on the cost of execution). Any alternative fee structure could attach either to a separate UK DC-specific vehicle or to a separate class of interest alongside other investors in the same fund (see "*Bespoke investment structures*" on page 24).

- **Co-investments.** Co-investments in a portfolio company alongside an investment by a private capital fund can be accessed for lower (or sometimes no) fees by investors with the right expertise and relationships. This is because co-investment opportunities are typically offered to investors that already invest in a firm's funds (due to competition between investors for a finite number of opportunities). A co-investment programme is very likely to reduce overall fees for a wider private capital programme, however it also brings diversification considerations and requires additional resources and experience within the scheme, adding to costs (see "Lessons from Australian DC", below for more on co-investment). However, successful co-investment programmes often require fund investment relationships with private capital firms in order to secure access to the best opportunities, which are typically prioritised to existing fund investors.

- **Incremental allocations.** A 1-2% percent portfolio allocation to, for example, venture capital, may not lead to a material increase of the overall total costs at the portfolio level, even with a management fee of 2% of investor commitments. Although smaller allocations will have a smaller impact on overall portfolio returns, they may allow DC investment teams to gain practical experience to help build a wider private capital strategy incrementally.

- **Smoothing management fees.** Management fee payments in a closed-ended fund are often highest at the beginning of a fund's life, and can later reduce as a result of "step-down" (explained in Annex 2) when the fund is in realisation mode (depending on the strategy and terms of a particular fund). Some fee smoothing modelling may help to keep fee payments constant from a DC perspective, and may result in a lower management fee overall, as a percentage of the allocation.

Fees: market insights on challenges and progress

2. Impact of fund structure and implementation

UK DC schemes need to consider implementation issues when deciding between investing directly into closed-ended funds or indirectly via an open-ended/evergreen fund (such as an LTAF) that itself then invests in underlying private capital funds. This choice affects fees because different fund vehicles require different approaches to fees. Closed-ended funds typically use a limited partnership, the drawdown model and 2 & 20 economics or a variation of them, whereas an open-ended, evergreen fund like an LTAF is more likely to charge a flat, NAV-based fee (though it may contain underlying funds that are structured with a 2 & 20 model). Most DC schemes, especially those outsourcing investments to third party firms, are likely to seek an evergreen fund structure with a flat fee, NAV-based pricing mechanism and an ability to make regular subscriptions for a long-term horizon over 10 years or longer (to deploy the significant inflows of savings capital from pension scheme members).

There are also considerations related to cash management for closed-ended funds. For instance, investments in closed-ended funds typically involve substantial, infrequent commitments to provide capital for portfolio company investments, and irregular distributions as those investments are sold (see Annex 2 for more detail). This pattern contrasts with DC schemes' consistent, regular cash flows that need to be promptly invested. The mismatch between DC scheme cash flows and the timing of private capital fund capital calls and distributions needs to be managed. Private capital funds usually charge fees based on committed capital rather than invested capital (see Annex 2), which can also be complex for DC to administer.

The ultimate choice between a closed-ended and an open-ended structure (or a combination of the two) will be influenced significantly by the scale of the DC investor and availability of DC-specific investment solutions such as an LTAF.

Some schemes, such as large master trusts or others with strong in-house private capital investment capabilities, may consider investing in closed-ended funds. However, there remain perceived challenges with the complexities of integrating closed-ended funds into DC portfolios, relative to integrating LTAFs.

"The main problem in DC is a practical administration problem, not even the fee. There is a mismatch of the accounting systems and the fact that DC assets are a number of small pots owned by individual DC investors, whereas a DB fund is a single entity."

– a commercial master trust

"In DC an evergreen structure is often seen as more attractive, and the fee can be charged on NAV. Some potential risks this creates: no pressure to sell portfolio companies, and controlling redemptions and dividends."

– an established venture and growth equity firm

"Over time, a closed-ended fund is the purest way to access illiquidity premium, but for now [to work in DC], the more obvious solution is evergreen."

– a large commercial master trust

"Most LPs [except DC investors] don't want an evergreen structure."

– an established venture capital firm

Fees: market insights on challenges and progress

Current market activity around solutions and innovations:

- **Bespoke investment structures.** Besides LTAFs, there are various innovative structures being developed and used, including: (i) platforms that can wrap closed-ended funds within a daily-priced unit-linked fund; (ii) semi-open ended private capital funds (often aimed at the wealth management market); and (iii) a more novel use of a limited partnership for an evergreen vehicle meeting the needs of both UK DC and non-UK DC investors, potentially with different economics for each and a lock-up period mirroring the life of a typical closed-ended fund, followed by liquidity options rather than termination of the fund. If UK DC capital can be successfully integrated in funds alongside other types of investor, UK DC would in theory gain much easier and wider access to private capital funds whilst benefitting from the scale and diversification that come with pooled investment vehicles holding portfolios of private companies (subject to the terms ensuring fairness between different types of investor).

- **LTAF investing in closed-ended funds.** Holding private capital funds and co-investments as part of a multi-asset vehicle makes it easier to translate 2 & 20 into a flat fee. Several providers are already proposing LTAF capital be invested in third-party closed-ended funds, with a co-investment element, as part of a diversified fund-of-funds product. The DC investor pays a flat fee whilst the underlying funds retain the traditional 2 & 20 fee model alongside a co-investment element to reduce the total fee burden.

- **Convergence in industry approaches.** Greater convergence in approaches for integrating closed-ended private capital funds into UK DC could address implementation challenges, especially for smaller schemes with insufficient resources for bespoke structures.

3. Ensuring fairness between scheme members

Carried interest is typically paid as a profit share on the realisation of investments (typically above a preferred return to investors, often of around 8%), closer to the end of the life of a fund. This has raised concerns that the unit price received by pension scheme members transferring out of the scheme before portfolio companies are sold (i.e. before carried interest arises) will be disproportionately high, relative to members who remain in the scheme when a portfolio company is sold (i.e. when carried interest arises) for whom carried interest payments might seem to reduce the value of their units.

Current market activity around solutions and innovation:

- **Accounting for accrued carried interest.** UK DC schemes could consider what lessons they can draw from the approach of Australian supers, which have integrated carried interest into a daily calculated NAV without major challenges. Reported valuations include accrued/deemed carried interest as a liability in the accounts, which means it is automatically netted off when calculating a member's unit price. This simplifies operational processes by removing from the ongoing unit pricing exercise any manual intervention to account for accrued carried interest. This helps ensure fairer distribution of carried interest between members over time (see "*Lessons from Australian DC*", below).

- **Frequent valuation and NAV adjustment mechanisms.** DC schemes seem broadly comfortable that quarterly valuations will provide sufficient comfort and transparency. In case of material events that affect valuations, it may make sense to agree an approach to adjusting the value of the fund or NAV between the valuation points.

Fees: market insights on challenges and progress

4. Familiarising DC schemes with private capital fees

Experts who contributed to Expert Panel's work in this area were unanimous about a huge opportunity for education for DC trustees and investment professionals around management fees and carried interest.

"We will need to take trustees on a journey, showing case studies and international examples of successful private market investments."

– a commercial master trust

"We need convincing answers on fiduciary duty and how J-curves align with VfM. It looks like there is a path to the resolve these challenges and education remains very important, especially of trustees."

– a commercial master trust

Having performance fees gives more flexibility in selecting quality managers. The market is trending in this direction and the inclusion of performance fees under the bonnet of existing structures is becoming more common."

– a commercial master trust

"There are probably a lot of myths to bust in private equity and VC because we haven't tried to access it."

– a commercial master trust

Potential solutions:

- **More case studies and best practices** on private capital investment innovation in the UK and overseas.
- **Cross-industry collaboration.** Continued work of bodies like the Expert Panel is needed to continue to focus on the implementation challenges, including fees and education.

Recommendation

DC schemes, private capital firms and their advisers should consider the market insights on fee innovations set out in this report.

Lessons from Australian DC experiences of investing in private capital funds

The Expert Panel's interim report gave a headline overview of Australian, US and Dutch pension markets, where schemes have been investing in private capital funds for decades. Australia stands out amongst these countries as a valuable case study for the UK DC market, given that Australian schemes have a strong record of investing in private capital funds despite facing some comparable challenges (such as cost sensitivity and consolidation of the provider market). Whilst Australia's DC system is clearly not a carbon copy of the UK's, the Expert Panel felt it was worth the UK industry considering in more detail whether lessons can be learned from the Australian approach.

The evolution of Australian supers' private capital fund programmes

Australian schemes have been investing in private capital funds that feature the standard "2 & 20" fee model for decades. This typically includes a 1.5-2.5% management fee, 20% carried interest, a preferred return of c.8% IRR, with some variations according to e.g. investment strategy/size.

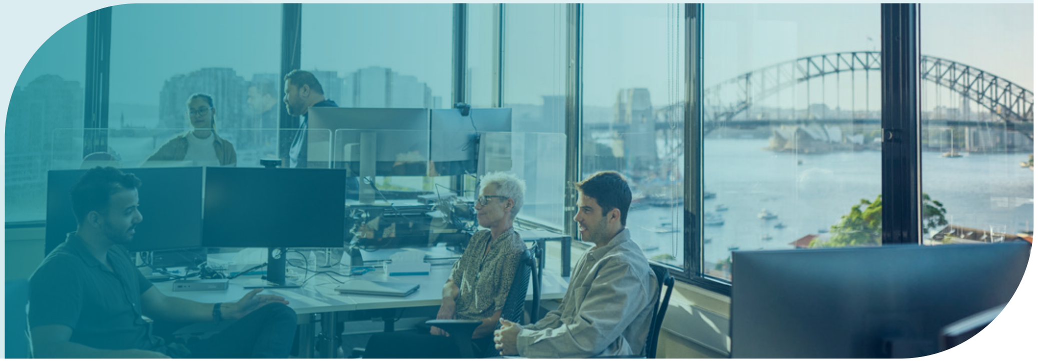
Initially, private capital was more often accessed through funds-of-funds, typically including a mix of primary fund investments, co-investments and secondary fund investments. A common approach was to use a fund-of-funds structure from a single intermediary with a total fee of 0.6-1.0%, plus carried interest. Most supers now mainly invest in private capital through closed-ended primary funds and co-investment (although funds-of-funds remain popular for more specialised strategies). External advisors are often engaged to supplement internal teams, typically to provide fee-based advice rather than discretionary management.

The Australian DC market did not initially focus too heavily on fees, in part because the Australian pension system has no charge cap. However, over time, competition and regulation have made fees, value for money, and reporting more prominent across all superannuation funds' investments. Today, major Australian supers manage diversified portfolios including private capital for a total annual charge that varies with performance but can be as low as 0.6-0.7% (although this is still higher than UK DC market).

Regulation has a strong emphasis on cost disclosures, with the regulator's "RG97" rules to ensure consistent reporting of all fees - performance fees, management fees and internal costs - that aim to ensure members can understand the fees they pay. Payments of carried interest are typically reported alongside other investment fees and costs. This greater regulatory focus has helped boost co-investment programmes (see below), but has not affected Australian supers' ability to invest in private capital funds.

"It is important to invest in the expertise required to build a successful private capital investment programme. The Australian supers have come a long way in private markets investing through many steps, so schemes may wish to consider building investment capacity incrementally."

– An Australian super fund



Lessons from Australian DC experiences of investing in private capital funds

Australian approach to private capital fee structures

The general consensus amongst Australian supers is that it is usually not possible to access closed-ended funds managed by leading private capital firms without being comfortable with the typical 2 & 20 model, which therefore remains very common for Australian supers' investments in private capital funds. That said, Australian supers have also used different approaches to ease the overall fee burden of their private capital programmes (which all rely on scale):

- **Lower carried interest:** Some Australian schemes have at times agreed lower carried interest, depending on commitment size, macroeconomic conditions and other commercial considerations.
- **Lower management fee:** Discounts or rebates on fund management fees can sometimes be negotiated (subject amongst other things to schemes being confident that the firm has sufficient resources, platform and track record to execute the strategy successfully at lower cost (see Annex 2)).
- **Co-investment:** Co-investment (sometimes offered to existing fund investors on a "no-fee, no-carry" basis) is one of the key tools that Australian supers have used to bring overall fee burdens down.
- **Strategic partnerships:** Australian supers have at times entered "strategic partnerships" with a single asset manager covering a range of private markets asset classes (which require analysis of the impact on returns of potentially more limited diversification and freedom of choice).

"Internalisation (namely direct investment in assets) is feasible but requires a highly skilled team, which takes time to build. Direct investment is expensive. The best approach is to hire experienced professionals who can guide fund selection and co-investment strategies."

– An Australian super fund

"Schemes should keep in mind the risk of concentration in partners or trying to use a single partner for all asset classes. Best practice in our view is to have a portfolio of GP portfolios."

– An Australian super fund

Lessons from Australian DC experiences of investing in private capital funds

Integrating carried interest into members' unit prices

Importantly for the UK DC context, Australian supers have found integrating performance fees into a daily calculated NAV relatively straightforward to manage, without major challenges. Private capital fund valuations are reported to DC schemes as a gross figure that includes, as a liability in the fund accounts, a specified amount representing accrued/deemed carried interest. As a liability, that amount is then 'automatically' removed from the net figure used to calculate a member's unit price, alongside any other liabilities (or "netted off"). This means that any carried interest that would have been paid if the fund's portfolio companies had been sold at that time (rather than after the member has transferred their interest) is removed from the unit price. This means that members who transfer out before carried interest is actually paid still bear the 'cost' of it, whilst simplifying operational processes by removing from the ongoing unit pricing exercise any manual intervention to account for accrued/deemed carried interest. This helps ensure fairer distribution of carried interest between members over time and could be an important consideration for UK DC schemes in simplifying the integration of carried interest into unit prices.

"Our fund managers provide detailed valuation statements (including a breakdown of carried interest), which our finance teams integrate into daily pricing models. This process is well-established among Australian funds, and it might be beneficial for UK funds to work with managers experienced in the Australian system. Effectively GPs provide the cost disclosures in the format that is familiar to the pension funds."

– An Australian super fund

Co-investment ratios in the Australian context

The recent drive to bring programme fee loads down has encouraged Australian supers to increase the ratio of funds-to-co-investments within their private capital programmes (co-investments in fund portfolio companies are often offered to existing fund investors on a "no-fee no-carry" basis). They have gone further than some global peers in this regard. For example, US pension plans, which often focus more purely on net returns, typically aim for a co-investment allocation of around 30% (with 70% invested through funds). Australian schemes' target co-investments typically form a relatively larger portion of their programme, perhaps 40-50%.

Considerations for establishing a successful co-investment programme

There are differences in opinion about the co-invest model and whether it might harm return or boost returns, depending on market conditions. One clearly important factor in running a successful co-investment programme is team capacity and experience. The Australian experience suggests that it takes considerable effort and a highly experienced investment team to generate alpha using a co-investment strategy, often with around 6-10 private equity professionals. A smaller private equity team may be more successful using a fund-of-funds approach, as Australian supers often did initially. For schemes that are unable or choose not to build sufficient in-house resource to manage a co-investment programme, another option is to allocate to co-investment funds, perhaps through a separate managed account arrangement with an asset management firm. This kind of approach is likely to be more suitable for more modest or "beta" return objectives, because it will typically have more diversified and generally large cap-focused exposure, where return outcomes can remain accretive to public equities, but typically fall within a narrower range.

Lessons from Australian DC experiences of investing in private capital funds

Australian advice on building a private capital programme

Before considering fees and terms, decide on the strategic objective of your private capital strategy, such as whether you want to access PE beta and target median returns or to generate significant alpha (e.g. outperforming the median by 4-6% p.a):

1. A "beta" focused private capital program might include a strategic partnership with one or more large asset managers and/or private capital firms, a highly diversified portfolio and a significant co-investment component. Such a strategy may only require a relatively small investment team (e.g. 1-5 people for a funds programme to 6-10 people for a significant co-investment allocation).

2. An "alpha"-focused PE program needs to target top-quartile or emerging private capital funds (which may even include a "super carry" component where carried interest ratchets up with performance). Co-investments and strategic partnerships may be less likely to enhance alpha on their own, but manager selection or highly experienced team or an investment advisor are key to success.

Recommendation

The Expert Panel recommends UK DC schemes use learnings from the experience of Australian DC schemes, especially around: (i) the operational integration of carried interest/performance fees; (ii) building private capital teams; and (iii) balancing fund investments with co-investments.

Further recommendations

Value for Money (VfM) framework

The Expert Panel recommended that the pensions industry should be empowered by the Government and regulators to move away from short-term cost considerations, to long-term net returns by DC pensions.

Since the interim report was published in September there have been a number of positive developments. In October 2024, the FCA consultation on a Value for Money framework closed, and in the interim report of the Pension Investment Review, published at the Mansion House speech in November, the Government confirmed its commitment to introducing the framework:

"We will ensure that any changes we make are reflected in the design of the upcoming VFM Framework. We want to create space for innovation and ensure all measures build on and complement each other."

The Government has also consulted on plans to allow the transfer of savers without consent, in contract-based schemes that do not offer value for money. This would put the put contract based schemes on par with trust based schemes in terms of powers to address poor value for money assessments in a future VFM framework. Though the outcome of the consultation has not yet been published, there is strong consensus that such powers would be beneficial to a stronger focus on long-term value.

In the same consultation, the Government consulted on proposals to regulate those offering both employee benefit and investment consultancy services. Again, there remains agreement on the key role consultants play across the landscape, and concerns about excessive weight being placed on cost. There is strong consensus that regulatory oversight of these services would be beneficial. Further proposals, relating to the role of employers in considering the long-term value of pensions have had a more mixed response. The outcomes of each of these areas are expected to be published by the Government in the spring of 2025, in advance of a Pension Schemes Bill in summer.

Further recommendations

Next steps

Though there remains a strong consensus that a value for money framework will be necessary to enable DC pensions to move away from the constraints of the focus on short-term cost, it also seems that the implementation of a framework is unlikely to take effect for some years. Primary legislation will be required to enable TPR to implement a framework and, at the time of publication, no consultation on the detail has been published by TPR (the FCA consulted in 2024).

The Expert Panel notes that the commercial pressures on DC schemes to reduce costs to remain competitive in the market remain very prominent, and is concerned that until this is addressed, DC pensions will be driven to short-term investment decisions. This is especially relevant given the Government's wider agenda, and the likelihood of significant consolidation of the market in the coming years.

The FCA's consultation proposes that schemes within scope would be required to report on historical investment performance over reporting periods of 1, 3 and 5 years and, where practical, 10 and 15 years.

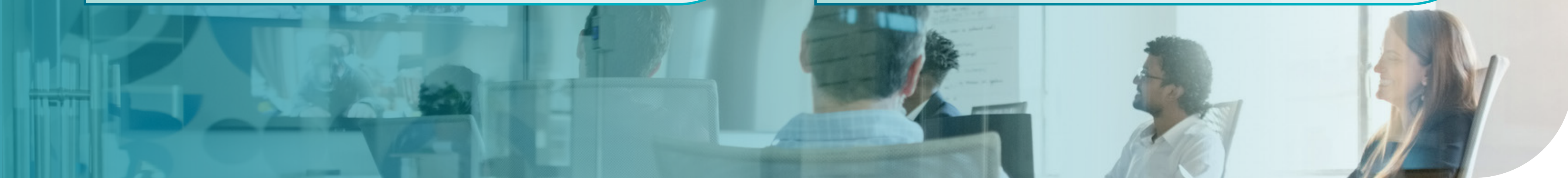
The proposals would also require that Independent Governance Committees (IGCs) follow a prescribed process when allocating a rating. A number of organisations have raised concerns that requiring IGCs to assign a rating, relative to the wider market, based on short-term metrics will prove to be a significant barrier to any scheme looking to make long-term private capital investments. This is both because of the potential J-curve investment cycle, and the risks clearly associated with being a 'first mover' within this system.

Recommendation

The Expert Panel urges the Government to progress with implementation of a Value for Money framework and provide clarity on how it will interact with other policy initiatives.

Recommendation

The Expert Panel recommends that the FCA and TPR act to ensure that the Value for Money framework does not make short-term investments a mandatory consideration for schemes serving long-term DC savers.



Further recommendations

Facilitating clarity on costs

In its interim report the Expert Panel identified inconsistency in cost disclosure requirements to be a challenge, and that there were a number of examples of misalignment across different regulators, and of rules not being accommodating of private market investments.

One example of this is the treatment of performance-based fees, which were excluded from the DWP charge cap rules for trust-based schemes in 2023. However, the equivalent change has never been made to the FCA rules for contract-based schemes, making it challenging for those providers to implement private market investments.

A further example is the approach of UK DC default providers to classifying different costs and charges as falling within or outside the charge cap calculation, based on DWP's charge cap guidance. As this guidance was designed largely with listed investments and retail funds in mind, it is insufficiently granular to provide consistent outcomes when applied to DC investments in private companies through private capital funds.

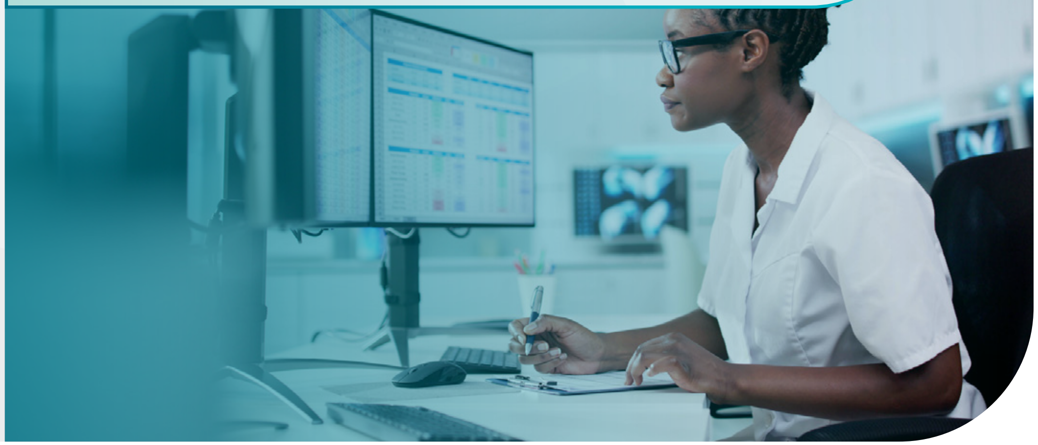
Various inherent costs of listed company investments (including debt, leverage and any investment costs) are not included within the TER. These costs do not disappear, rather they reduce the public company's profits and its share price. This approach of excluding inherent costs from the TER figure is also the approach used for real estate fund investments, where items such as valuation costs, building repairs etc. are deemed to be inherent costs of investment rather than additional charge for inclusion in the TER.

The equivalent inherent cost items for private capital fund investments are typically included within the TER (thereby increasing the TER figure for private capital investments, relative to listed investments). These items include the TER of any underlying investee funds and potentially the costs of operating and managing holding structures (the DWP guidance is unclear on this point).

The Expert Panel considers that the same approach to reporting costs should be used for both public company and private capital fund investments. This is particularly important for the Value for Money framework, which will bring additional cost disclosure requirements.

Recommendation

The Expert Panel recommends that the Government revises its guidance on the application of the DC charge cap, to ensure that costs are disclosed in a comparable manner across both public and private markets.



Further recommendations

Maximising the potential of LTAFs

The Expert Panel recommended the FCA should consider making targeted changes to the relevant regulations so that investor access is not unduly restricted and more LTAFs are encouraged to come to market.

Though the Expert Panel acknowledged that LTAFs are not the only solution for pension schemes looking to implement private markets allocations, it noted the important role the new framework is likely to play, and was supportive of the FCA's work on it to-date.

The Expert Panel noted the need for LTAFs to reach scale, and for the FCA to continue to monitor the framework and be open to changes to the rules that would enable more LTAFs to come to market. For example, the Expert Panel highlighted several rule changes that could assist with this, as set out in the interim report.

In September 2024, the FCA consulted on rule changes to Non-UCITS (Undertaking for Collective Investment in Transferable Securities) Retail Scheme (NURS) products that would make it easier for them to invest LTAFs. This should make it easier for LTAFs to raise capital from NURS funds, and thereby achieve greater scale. The views of the Expert Panel were highlighted during the consultation period, and the rule change has since been implemented[7]. The Expert Panel welcomes this move.

It is clear that LTAFs remain a popular vehicle, particularly for pension providers that invest through life insurance platforms. The FCA register currently shows authorisation has been given to 27 LTAFs. At the time of the Expert Panel's interim report this figure was around 11.

As further LTAFs come to market, and pension schemes continue to explore which methods work best to meet their private market allocations, it is important that the FCA continues to monitor the framework and seek opportunities to improve it.

Recommendation

The Expert Panel continues to support a formal post implementation review of the LTAF framework once a greater number of LTAFs have come to market.

Platforms

In its interim report, the Expert Panel recommended that life insurance platform providers should continue to expand private capital options for DC schemes.

The Expert Panel notes a number of interesting new partnerships announced in recent months, and feels there is evidence that the various parties across the DC landscape are increasingly working together to find solutions to ensure that private capital options are available to DC.

Recommendation

The Expert Panel welcomes the increasing progress by life insurance platforms and encourages continued innovation in this space.

[7] https://www.fca.org.uk/publication/handbook/handbook-notice-125.pdf

Further recommendations

Liquidity

The Expert Panel recommended regulators should work with industry to provide reassurance, and updated guidance, on their liquidity expectations for how DC schemes should handle stress events and their impact on liquidity.

This topic has been flagged in engagement with the Expert Panel, which notes that this will continue to be a consideration moving forward, in light of a number of areas of policy focus. For example, the introduction of pensions dashboards, and initiatives aimed at addressing the proliferation of small DC pots. The Expert Panel also notes that the proposals consulted on by the Government, which would require the existing DC landscape to consolidate considerably, will require the careful management of liquidity by those schemes that are likely merge.

Recommendation

The Expert Panel recommends that regulators ensure that schemes are clear expectations around liquidity as the landscape evolves.

To and through investing

In the interim report, the Expert Panel recommended that DC schemes consider the role of 'to and through' investing, with a view to keeping savers invested in private capital investments for longer periods of time.

To date, 'life-styling' investment strategies have reduced exposure to growth assets approaching and at retirement. Columbia Threadneedle estimates that life-styling reduces performance by an average 2.3% per year, and reduces the pot for investment in UK investment opportunities by £10-25 billion a year. This trend is linked to the risk adverse culture of UK pensions, relative to the culture of other countries with comparable DC landscapes.

The Expert Panel notes that growing discussion and acknowledgement of the need for DC savers to remain invested in growth assets to and throughout retirement is encouraging, and that there are notable examples in the market of schemes implementing this successfully.

Recommendation

The Expert Panel recommends that DC schemes continue to implement strategies that will ensure savers are invested in growth assets both to and through their retirement.

Further recommendations

Quarterly valuations

In its interim report, the Expert Panel recommended that DC schemes, platforms and advisers should use quarterly private capital valuations, alongside appropriate governance for unusual liquidity events, to ensure fairness between members in unit pricing.

Since the publication of the report in September, it is clear that a larger number of DC schemes are exploring how to implement private capital investments into default funds. Though each provider has to consider how to approach valuations in a manner appropriate for their own circumstances, the Expert Panel is encouraged that most appear to be growing comfortable with quarterly valuations.

The Expert Panel notes the findings of the FCA's private markets valuation review, published in March 2025. On transparency of private capital firms' communications with investors around valuations, the FCA found that "most firms demonstrated good practice by reporting quantitative and qualitative information on performance at both the fund and asset-level, as well as holding regular conference calls with investors." The review made it clear that quarterly valuations are the market norm, whilst ad hoc valuations between quarters currently remain uncommon.

Recommendation

The Expert Panel recommends that UK DC schemes, platforms and advisers continue integrating quarterly private capital valuations into member unit pricing.

Further recommendations

'Permitted links' rules

In the interim report, the Expert Panel recommended that the FCA should review and amend the 'permitted links' rules.

In the Expert Panel's earlier discussions, it was acknowledged that the LTAF structure was well suited to the needs of DC schemes looking to invest in illiquid assets. However, it also recognised that there remains a need for other options. Given this, it noted that existing permitted links rules are a barrier to DC pensions accessing a wider range of investments via unit-linked life insurance platforms. The Expert Panel recommended that the FCA consider two routes to address this barrier:

- Excluding default funds of DC schemes from the 'permitted links' rules.
- Including certain private capital funds explicitly as conditional permitted links and exempting them from the 35% cap on illiquid assets.

The proposed changes have been raised by industry associations in subsequent consultations, including the FCA's Discussion Paper 'Pensions: Adapting our requirements for a changing market', and in BVCA evidence to the House of Lords Financial Services Regulation Committee. However, no indication has yet been given as to whether this is something that the FCA is actively considering.

The Expert Panel remains of the view that permitted links rules continue to be a barrier for DC schemes that use life platforms to invest, in comparison to those that do not. The Expert Panel does not agree that there is any difference in their governance standards that warrant such an uneven playing field.

Recommendation

The FCA should ensure the 'permitted links' rules are amended as soon as possible to widen private capital investment options for DC default schemes that use life insurance platforms.

Further recommendations

Risk pooling and Collective Defined Contribution (CDC)

In the interim report, the Expert Panel recommended that the FCA should review and amend the permitted links rules.

In the interim report, the Expert Panel recommended that industry and Government should work together to determine how risk can be better pooled in DC structures, in the interests of savers. In particular, CDC schemes should continue to be explored. The Expert Panel explored the role of collective risk pooling, a clear benefit of DB pensions that has not been replicated in the DC landscape that has emerged following the introduction of auto-enrolment. The Expert Panel felt that DC and policy makers could do more to improve this situation.

Collective Defined Contribution (CDC) is seen by many as the most likely model, with elements of DC, but with the potential risk pooling benefits of DB. However, at the time of the interim report, no schemes had been launched, and the lack of any regulatory framework for multi-employer schemes likely to prohibit access to CDC for most employers, and therefore pension savers.

Since the interim report was published there have been two significant developments in the progress of CDC:

- On 7 October 2024, the Royal Mail launched the first UK CDC scheme.
- The Government consulted on draft regulations that would enable multi-employer CDC. If progressed, this is likely to mean secondary legislation in 2025.

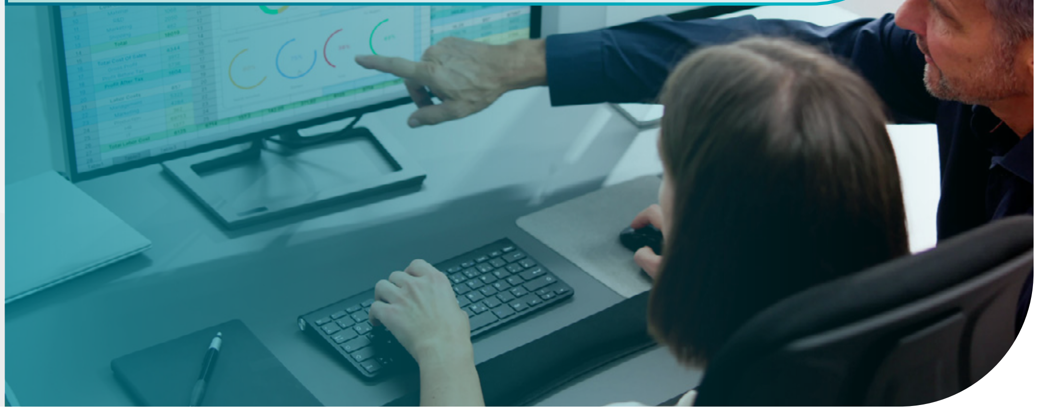
Looking forward

In her foreword to the consultation, the then Pensions Minister Emma Reynolds said she "intend(s) to deliver it to ensure as many savers as possible can take advantage of the numerous benefits of CDC", and it is clear that there remains clear support for more risk pooling for DC savers.

The pension announcements made in the Chancellor's Mansion House speech in 2024 did not propose any specific changes to CDC, though many have raised concerns that the proposed size thresholds for DC schemes could have a detrimental impact on the emergence of CDC, and proposed that they should be exempt from the proposals.

Recommendation

The Expert Panel notes that the Government should continue to consider how CDC, and any other risk pooling models, can continue to develop as the DC landscape evolves over the coming years.



Annex 1: Guidance on the Request for Proposals process

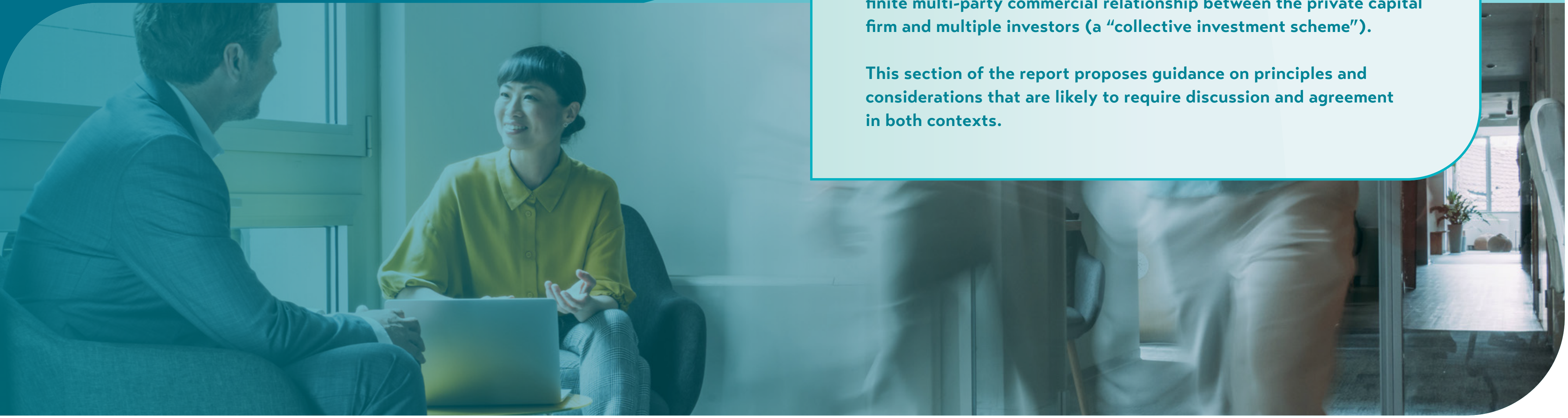
The following guide aims to provide guidance for private capital firms, UK DC schemes and their advisers, on the areas that should be discussed and agreed when UK DC schemes are seeking and agreeing private capital fund investments. It aims to provide a UK DC-specific lens that can be used in conjunction with existing tools to support the assessment of private capital fund investments by prospective UK DC investors, such as the Institutional Limited Partners Association's template Due Diligence Questionnaire. References to General Partner (GP) are to a private capital firm and references to Limited Partners (LPs) are to investors in private capital funds.

Explainer: DDQ vs RfP

UK DC schemes will be familiar with Requests for Proposals (RfP), which are often the method by which DC schemes seek to agree the terms on which an asset manager will provide asset management services to the DC scheme. This process is about establishing an open-ended bilateral commercial relationship.

Private capital firms will be familiar with Due Diligence Questionnaires (DDQ), which are the method by which LPs typically seek to understand and influence the structure and terms of an existing or proposed closed-ended fund in which the LP will be one of many investors. This process is about establishing a long-term but finite multi-party commercial relationship between the private capital firm and multiple investors (a "collective investment scheme").

This section of the report proposes guidance on principles and considerations that are likely to require discussion and agreement in both contexts.



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What structure is being sought?

It is helpful for RfPs to include information about how the fund or broader allocation would sit within the DC scheme's wider portfolio, and any information that can be shared on whether any specific structure might be required. For example, is the DC scheme seeking to invest in the fund through an existing Long Term Asset Fund (LTAF), seeking a partner to establish a new LTAF, or not constrained by the need for an LTAF? LTAFs have specific liquidity and other requirements, so private capital firms need to be clear on where this intended allocation would sit within a wider private markets allocation, and what is needed in terms of liquidity. This may impact which private capital firms are equipped to respond to the request, and therefore it is worthwhile all parties having an overview of where this allocation would sit overall.

How far is the scheme working within permitted links constraints?

Pension providers using unit-linked life insurance platforms will typically be constrained by the FCA's permitted links rules, which restrict which investments can be made. For example, platform users are restricted in terms of which structures they can invest in (such as LTAFs), which would be a relevant consideration for any private capital firms looking to respond in the RfP process, and so should be set out up front.

What jurisdictions would be considered or excluded for structuring?

Private capital funds are often structured using different UK and non-UK (e.g. EU or US) vehicles, and often invest across a number of geographies to ensure diversification. It is therefore useful for any restrictions or preferences on jurisdiction of structures and investments to be highlighted. For example, whether the pension scheme is ideally looking to invest primarily in the UK structures or UK portfolio companies, or even companies in a specific region within the UK. Are there reporting requirements that will require them to report on UK investments within the portfolio? Importantly, it is useful to ensure information is included on any restrictions in jurisdiction as a result of any pre-established investment strategy of the fund (this can come in the form of concentration requirements (e.g. 70% of a portfolio must be in UK assets) or limits (e.g. no more than 20% must be in the UK).

Are there fee constraints in place that should be set out up front?

For both parties, keeping an open mind on fee structures and levels is a positive when seeking opportunities. However, if the pension fund has a clear, non-negotiable policy in place then this should be highlighted up front.

In reality, investor demand for funds offered by private capital firms with strong track records may sometimes reduce flexibility in such instances. Equally, private capital firms should indicate as early as possible whether they have any room for manoeuvre on the fund's economics, particularly as regards ongoing management fees. This will require assessment of the terms that other investors in the fund have agreed, the resources required by the private capital firm to execute the strategy, and commercial considerations. Private capital firms should also clarify up-front the fund's approach to fund expenses and any charges that may be borne by the fund outside the management fee, as well as any fee offset mechanism that may reduce the management fee payable to the firm by the amount of any related fees the firm receives from third parties (such as fees the firm might charge to portfolio companies). Examples of this type of expense are listed on page 25 of ILPA's template DDQ.

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What potential is there for the DC scheme to be offered co-investment opportunities?

UK DC providers' commercial fee-sensitivities may mean they seek to make greater use of co-investments than other investors, to reduce the overall fee burden reported to employers and savers. Both parties should give consideration at the outset to the potential level of co-investment opportunities that the DC provider may expect to be offered.

What arrangements are already in place for other investors in the fund?

If a DC scheme is seeking to invest in an existing fund proposition where the DC scheme capital will be comingled with that of other investors, both parties will need to be clear on how far there is scope to agree specific arrangements that deviate from terms acceptable to other investors in the fund, as private capital firms will typically have a commercial imperative and legal duty to treat all investors fairly.

How frequently will fund valuations be provided, and how will the GP ensure valuations are robust?

Historically, the UK DC environment has received daily pricing across its investment portfolios, which facilitates the pricing of individual pension savers' units in the wider scheme (as the basis for reporting and liquidity). However, the standard approach to the valuation of private companies is an involved process that would be impractical and prohibitively costly to perform on a daily basis. There is growing recognition that the industry standard approach of conducting quarterly valuations should be considered reasonable in the DC context, and the Expert Panel interim report discusses in further detail (page 46) how this may work in practice.

It is important that both the frequency of valuations and the governance and methodology to which the private capital firm will adhere are considered and agreed upon during the RfP process (e.g. whether the firm is subject to FCA/EU regulatory requirements under the Alternative Investment Fund Managers Directive, and whether it follows the International Private Equity Valuation guidelines). Generally, UK DC investors should expect a high degree of openness and transparency around valuations from private capital firms. The FCA's private markets valuation review recently described good practice as "reporting quantitative and qualitative information on performance at both the fund and asset-level, as well as holding regular conference calls with investors".

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What reporting will be required?

UK pension funds are subject to specific reporting requirements that may not be typical for overseas pension funds, or other institutional investors. Private capital firms should ensure that they familiarise themselves with the specific requirements during this process, and review whether they are in a position to collect this information. Consideration should be given, for example, to what sustainability reporting requirements are in place, expectations around stewardship, and how reporting of fees (including 'look through') will be captured. In the future, consideration should be given to the Value for Money framework. Expectations should also be set with regards to frequency of reporting.

ESG factors typically play a significant factor in private capital investments, with the active ownership model being fundamental to the process of value creation. However, GPs may be less inclined to sign up for mainstream reporting standards, as they are often designed with public market ownership models in mind. Investors should gain an understanding of the firm's approach to ESG, including how it plans to monitor, influence and report on material factors. It is also worth exploring whether the firm has specific in-house policies that are relevant, or whether it is signed up to specific ESG-focused initiatives, such as the UN Principles for Responsible Investment (which has private equity specific guidance), or Invest Europe's reporting standards.

How is alignment of interests to be ensured?

Alignment of interests is a key element of private capital fund investment because of the importance to value creation/returns of the private capital firm engaging in long-term "active ownership" (growing the business through hands-on engagement) during portfolio company holding periods.

Fee structures for private capital funds therefore almost always feature carried interest (a profit share, typically of around 20%), alongside a flat fee to cover execution of the strategy. Carried interest does not arise unless and until portfolio companies are realised at a profit for the fund (i.e. exits generate more returns than the amount of money investors have contributed, including management fees, plus any preferred return). It is important to ensure that private capital firm does not participate in the fund's profits unless and until investors' initial capital contributions plus the costs of executing the strategy have been returned to investors and a preferred return, typically around 8%, has been delivered.

In a closed-ended fund context this is relatively straightforward to ensure, as these terms are largely the industry standard globally. For the more novel approach of using open-ended funds for private capital investment, DC schemes and private capital firms may need to give greater consideration to how best to ensure the long-term alignment of interests, potentially borrowing ideas from hedge funds (where 2 & 20 is applied in a liquid context, fees are based on NAV (rather than realisations) and features such as high water marks are often incorporated to foster appropriate alignment).

Another important feature of alignment of interests is the "GP commitment". Investors in private capital funds also almost always require the private capital firm/its key investment professionals to make personal commitments of capital to the fund, thereby ensuring they are personally invested in the outcome.

None of these arrangements are set in stone, and depending on the circumstances, there may be room for negotiation. However, pension schemes may wish to consider how they can best ensure close alignment of interests with the private capital firm.

Annex 1: Guidance on the Request for Proposals process

What predecessor funds can the private capital firm point to?

Information on the private capital firm's track record should be communicated fully and effectively. Prospective investors contemplating an investment decision should expect details of previous and existing funds managed by the firm, including total amounts of invested and realised capital, number of companies invested in and realised, loss rates and performance data. This should include gross and net figures both for IRR, but also multiples of invested capital (MOIC). Investors should also seek details of individual portfolio company investments, including the name of the companies, what stage (series A, growth etc.), and how much was invested. This will paint a picture of how proven is the ability of the firm's team in growing companies, realising value, and generating strong returns.

What is the minimum size of investment in the fund?

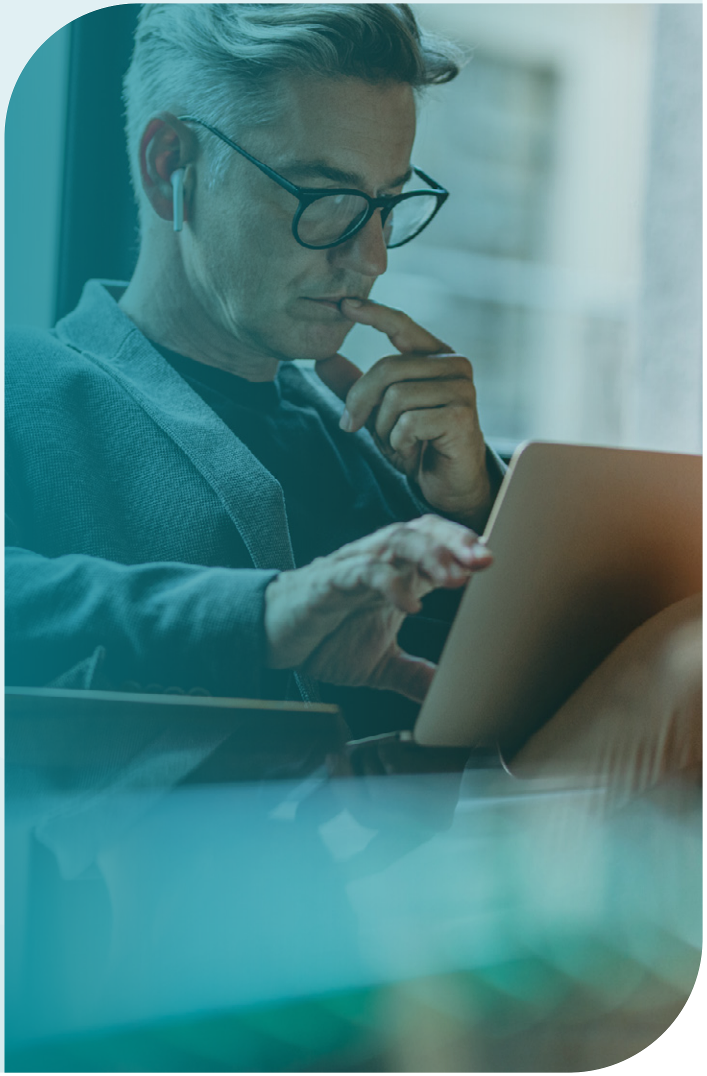
It is worth setting out up front whether there is a minimum size of investment ("ticket size"), and any limits on how much of a fund the DC scheme is willing to invest. Many LPs are not willing to invest more than a certain percentage of a fund (often around 10%), in order to promote diversification and ensure an appropriate level of risk pooling with other investors. Many private capital firms, particularly those with a regional focus, or that focus on earlier stage and mid-market companies, make smaller investments using smaller fund structures. DC investors should consider whether the minimum size of the investment they make will restrict what outcomes they are seeking to achieve.

What is the proposed term of the fund?

Private capital funds typically last around 10-15 years (often with extensions subject to investor consent), with no opportunity to exit other than via a secondary sale to another investor. Investors should consider and set out a minimum hold period/preferred investment horizons at the outset.

What are the relevant investment beliefs that would apply?

DC pension schemes will often have specific investment beliefs – private capital firms should ensure that they are aware of those, and able to implement them, at the outset. For example, this may cover ESG and policies, specific exclusions, geographical restrictions, or expectations on the DEI credentials of the fund.



Annex 1: Guidance on the Request for Proposals process

What is the anticipated investment pace and portfolio construction?

Private capital fundraising does not consist of investors providing capital to a fund as soon as the firm and investors execute the contract to invest in the fund. Instead, the fundraising process consists of the firm securing contractual commitments from investors to provide capital periodically to the fund on typically ten days' notice as and when the firm has finalised negotiations for the acquisition of target portfolio companies and the fund's capital is needed to complete the corporate transaction. Private capital fund agreements typically allow three-to-five years for the firm to deploy capital committed by fund investors in this way, a period known as the "investment period".

The expected pace of capital deployment and the length of the agreed investment period (effectively a backstop for deploying investors' capital) are important considerations for DC investors to be made aware of when assessing private capital fund propositions. This is particularly the case given the challenge of ensuring that significant, ongoing DC member inflows can be deployed effectively and that J-curve returns profiles (which means funds often experience a short term dip in performance, before growing over the longer term) do not excessively prejudice fairness between scheme members. However, DC schemes should balance this with the need for careful deal selection to ensure maximum return potential – quickly deploying capital is not necessarily always the most effective means of achieving this.

Draw downs, distribution and redemption processes

It is important for discussions to cover how the investment process will work in practice. For closed-ended funds, rather than transferring the total amount of investment capital to the fund on day one (as will be the case for most open-ended funds like LTAFs), an investor will typically agree to provide capital to the fund on demand with around ten days' notice up to a specified maximum amount (the LP's "commitment"). As touched on above, the private capital firm will then "draw down" tranches of capital from investors, mostly during the first few years (typically up to five) of the fund's life, for the purposes of acquiring portfolio companies (and paying management fee and expenses). Investors should be aware of the draw down provisions including whether any bank finance might be used to make drawdown requests more regular and predictable (acquisitions will happen irregularly but can be temporarily funded by short term bank debt which is then repaid from e.g. quarterly drawdowns).

It is important also to note that closed-ended funds typically cannot hold cash for any length of time within the fund without investing or distributing it to LPs (except in certain circumstances that should be specified in the fund documents). This is in contrast to LTAFs, which will typically hold liquid assets for the purposes of meeting redemptions.

Annex 1: Guidance on the Request for Proposals process

How is the private capital firm regulated and what is its approach to risk management?

DC schemes should seek detail on how the private capital firm is regulated in the UK and or elsewhere. In contrast to LTAFs, the individual private capital funds that the firm manages or operates will themselves typically not be regulated. As well as UK regulation, firms are often also subject to US, EU or Channel Islands regulation. Firms' approaches to risk management will usually be underpinned by regulatory requirements, and DC schemes should explore in discussions how a firm approaches investment risk, from due diligence, through ownership to exit. For more detail on risk considerations in private capital funds, see pages 36 and 37 of the interim report).

How does the GP plan to exercise the fund's significant influence or control over investments?

Private capital managers typically generate profit by buying companies and improving or growing them, before selling them. Investors should gain an understanding of this process at the outset, and be clear about whether the GP obtains controlling positions or, if not, how they plan to ensure they can influence minority investments. Active ownership is a key component of the private capital model. However, it is very different from the stewardship model typically applied in relation to public market investments, and so both parties should form an understanding of how value will be added, and what kind of monitoring and reporting the LP should expect. It is also worth gaining an understanding of how the fund seeks to exit investments once it has achieved its goals.

Whether the fund may undertake activities that could be considered trading in nature?

There are specific tax exemptions for UK pensions on returns that are deemed to be investment in nature, but returns from trading are taxable. It is therefore important to provide information on any investment activity that may fall within this category, for example, where investments are disposed of quickly. If this is a possibility, what will the GP do to ensure that the information on it is reported to the pension scheme?

Annex 2: Explainer: private capital fund economics and fees

This section describes typical features of the fee structures of closed-ended, self-liquidating private capital funds used widely in the private capital programmes of global institutional investors. LTAFs and other open-ended products do not feature the same fee structures as the closed-ended model, but LTAFs may invest in underlying funds that do. Any investors seeking more direct or concentrated exposure to private capital will also encounter closed-ended funds. Therefore it is important for UK DC providers and advisers to be familiar with market standard approaches to fee structures in closed-ended private funds.

Why are private capital funds typically closed-ended?

Explainer (liquidity match): Closed-ended funds (i.e. funds with no redemption rights) match the illiquidity of private company shares, which are not listed or traded and so cannot be sold on a public market to fund investor redemption requests. They also fit well with the private capital value creation model, which rests on a planned portfolio company holding period of three-to-seven years or more. Combined with personal equity incentives for portfolio company founders and management teams, these finite hold periods focus the company's efforts on maximising value before it is sold. Unscheduled redemptions during that hold period might force an early "fire-sale" of a portfolio company and interrupt its business plan before completion, reducing returns for both the redeeming and non-redeeming investors. In any event, such requests would in theory require the sale of the investor's percentage interest in each of the fund's portfolio companies, which is not feasible in private markets.

Considerations for UK DC schemes: Closed-ended funds typically use the drawdown model (see Annex 1 for an explanation) and "2 & 20" economics or a variation of them (2% ongoing management fee, plus 20% carried interest, explained below), whereas open-ended, evergreen funds like LTAFs are more likely to charge a NAV-based flat fee (though they may contain underlying funds that are structured with a 2 & 20 model).

Why do private capital funds have an ongoing management fee plus carried interest?

Explainer (execution and incentive): Fund management fees are designed to allow the private capital firm to cover the costs of executing a fund's investment strategy (including during the holding period). In contrast, carried interest is seen as a long-term incentive to ensure that "active ownership" (see below) maximises the likelihood of outsized returns, because it grants the firm a profit share of the upside if the fund performs well. Under typical private capital fund distribution 'waterfalls', management fees are effectively repaid to investors if the fund makes a profit (i.e. has returned all investors' capital, plus a preferred return to investors of typically 8%), before any carried interest is paid to the private capital firm. The realisation basis for carried interest means that the carried interest is only paid once investors have actually realised a cash profit after all costs and fees have been accounted for.

Annex 2: Explainer: private capital fund economics and fees

Considerations for UK DC schemes: This inter-relationship between the two elements of a fund's economics means that UK DC schemes need to consider any changes to the rate or frequency of one from the angle of their impact on the other, and how the combined impact of any particular combination is likely to make a positive contribution to members' overall net returns. For example, a higher management fee with a lower carried interest might raise questions about whether the firm is sufficiently incentivised to invest in the team needed to grow portfolio companies over the long-term (rather than simply collect management fees during the holding period). Equally, a lower management fee might raise questions about the firm's ability to execute the investment strategy effectively (see below). A higher carried interest might be a powerful incentive that leads to stronger returns, but it might also encourage a riskier approach than investors are seeking, or the opposite, if seen as unachievable by the firm. These are examples of the considerations that UK DC schemes will need to balance in this context, during negotiations with private capital firms.

How are management fees calculated?

Explainer (differences with NAV-based models): Private capital fund management fees are structured and calculated in a fundamentally different manner to fees charged for open-ended products investing in liquid assets. They are not charged as a percentage of a fund's NAV on an ongoing basis. Instead, private capital fund management fees are initially charged (typically at between 1.5% and 2.5%) on "committed capital", during the period of the fund's life where capital is being drawn down from investors to acquire companies (which is typically three-to-five years). In contrast to NAV-based fees, this is a certain, fixed amount that does not rise or fall with the value of the fund's assets. After this "investment period" ends and the fund stops making new investments, the management fee might remain at the same rate (or, sometimes, the rate might change) but its basis of calculation usually drops to being on "the acquisition cost of unsold assets" or a variation thereof (this change is called "step-down", as the cash amount of management fee payments starts to decrease as portfolio companies are sold). This is a common approach to "step-down", but there are others.

Considerations for UK DC schemes: This difference in the basis of calculation must be taken into account when assessing the cost of private capital funds relative to open-ended funds for which ongoing charges are typically calculated as a fixed percentage of NAV. To illustrate this, over the c.10 years of a fund's life, a charge of 2% of committed capital with a step-down towards zero after the investment period will often be less expensive overall than a charge of 2% NAV throughout those 10 years (depending on the NAV-based fund's performance!). Performance aside, fees based on committed capital and fees based on NAV should not be compared as like-for-like. Schemes should also note that charging fees on committed and invested capital (instead of on NAV) means valuations are not relevant for management fee calculations (subject to some limited exceptions).

Why are fees charged before capital is invested?

Explainer (identifying and executing investments): Fees are charged on capital an investor has committed to make available to the fund (rather than the amount that has been invested at any point) during a fund's investment period. This allows the private capital firm to cover the significant and sustained up-front expenditure needed to identify and execute investments in private companies, as a fund's portfolio is built steadily over a three-to-five year period (unlike a fund investing in liquid securities, it is neither practicable nor desirable for the portfolio of investment to be purchased as soon as the fund closes). An equivalent to the detailed, standardised, public data on listed companies that allows public markets to function fairly and effectively does not exist for start-ups, scale-ups and SMEs (for proportionality reasons).

Annex 2: Explainer: private capital fund economics and fees

This means that potential investments cannot be identified and fully-analysed using public data alone, and large amounts (in time and money) of specialist expertise and networks of relationships are needed in order to develop a pipeline of potential investments and present a compelling case that can pass the scrutiny of a firm's investment committee. Then, to execute an investment decision, in contrast to public markets (where execution can happen almost instantaneously), the private capital firm must conduct in-depth commercial and technical due diligence based on information disclosed confidentially by the company, negotiate and agree investment/acquisition terms, and arrange financing and/or co-investment.[8] Each of these steps requires specialist in-house expertise as well as significant involvement and management of banks, insurers, external lawyers, accountants, specialist consultants and other third parties, and can take months or longer.

Considerations for UK DC schemes: Charging fees on committed capital whilst capital is drawn down from investors is an unfamiliar model to UK DC schemes and may raise questions around administration and cash management. In practice, investors typically fund drawdowns from the sale of other liquid assets rather than cash, ensure that private capital firms communicate effectively, and explore whether the firm has bridging "capital call" facility that can allow for regular and predictable quarterly drawdowns (with acquisitions between quarters being funded from the facility).

Why do management fees continue to be charged after investments have been made?

Explainer ("active ownership"): Once the fund has made an investment in a portfolio company, that investment's ultimate success depends on the "active ownership" carried out by the firm during the holding period, which requires significant, sustained effort and expenditure. Every firm has a different approach, but typically a private capital firm will use the significant influence or control that the fund's large minority or majority ownership position brings to: (e.g.) ensure that the fund is represented on the board; help the company establish a business plan and value creation strategy for the hold period and beyond; bring in professional executive leadership (e.g. a new CEO, CFO etc.); optimise governance and management and employee incentives; drive the implementation of technological improvements; identify and help execute strategic mergers and acquisitions; implement sustainability improvements etc.; and then conduct an exit (which means running a second private M&A transaction, this time as a seller). All of this requires much greater, hands-on involvement of senior business and investment specialists in the private company's fortunes than in a public company investment context.

Considerations for UK DC schemes: The key purpose of the management fee is to allow the private capital firm to execute the investment strategy, but market forces will also play a role in determining the level for a particular fund. UK DC schemes may wish also to consider execution costs, the impact of economies of scale and the resources of the private capital firm as part of their assessment of a proposed management fee level. They should bear in mind that a lower management fee will not necessarily deliver better net-of-fee returns.

How and why do management fee levels vary between private capital strategies?

Explainer: As described above, private capital fund management fees typically cover the firm's execution of the strategy (fundraising, pipeline, investment execution, active ownership during hold period, and exit). The level of management fee varies typically between around 1.5% or less and 2.5%. There is no hard-and-fast rule determining where a particular fund will fall on that spectrum, and both macro and micro market forces play a role. But it is fairly common for larger funds to have a relatively lower level, whilst smaller funds sometimes have a higher level.

[8] In a private equity context, execution is a full-blown private M&A transaction process, often conducted through auction involving a small number of bidders, that can take six months or longer. For venture capital investments, execution involves an often-complex negotiation centred on agreeing changes to a company's shareholder register (the "cap table") in which a range of shareholder rights need to be balanced as part of a multi-party funding round (seed, series A, series B etc.).

Annex 2: Explainer: private capital fund economics and fees

Considerations for UK DC schemes: The key purpose of the management fee is to allow the private capital firm to execute the investment strategy, but market forces will also play a role in determining the level for a particular fund. UK DC schemes may wish also to consider execution costs, the impact of economies of scale and the resources of the private capital firm as part of their assessment of a proposed management fee level. They should bear in mind that a lower management fee will not necessarily deliver better net-of-fee returns.

How does carried interest and "GP commitments" seek to ensure long-term alignment of interests?

Explainer ("GP commitments"): Private capital firms typically invest some of their own money into the funds they are responsible for investing. This is known as "GP commitment" and is usually required by investors as a method of ensuring the firm has "skin in the game" and is motivated to ensure the fund performs well. The amount invested depends on the industry sector and can be 1-5% of total fund size or more. Often the money will be invested personally by more senior investment executives responsible for the success of portfolio companies.

Considerations for UK DC schemes: GP commitment is considered a key element of the long-term alignment of interests between investors and the private capital firm (especially on the downside), as it effectively places key personnel at the firm in the position of investors themselves. When considering the appropriate amount of commitment by a firm/its key executives, UK DC schemes should consider market terms, the risk of too high a commitment making the private capital firm too risk averse, and the personal liquidity circumstances of the specific key executives responsible for generating the fund's returns.

What is the difference between management fees and fund expenses?

Explainer: Fund expenses relate to the establishment and running of a specific fund (e.g. legal, structuring and audit costs of the limited partnership, plus external advisory fees incurred when making or realising investments), as distinct from the costs of the manager itself in employing specialised business and investment professionals, fundraising and its own legal and other costs (which are covered by management fee). Fund expenses are typically covered pro rata by the investors in a particular fund (including the private capital firm in respect of its GP commitment).

Considerations for UK DC schemes: UK DC schemes should clarify up-front with the private capital firms what a fund's approach will be to fund expenses and any charges that may be borne by the fund outside the management fee, as well as any fee offset mechanism that may reduce the management fee payable to the firm by the amount of any related fees the firm receives from third parties (such as fees the firm might charge for certain services it procures for portfolio companies). Examples of this type of expense are listed on page 25 of the template Due Diligence Questionnaire proposed by the international industry association for investors in private capital funds (the Institutional Limited Partners Association (ILPA)). They are also covered in the Cost Transparency Initiative's Private Markets Template that was created by the PLSA, BVCA and Local Government SAB following the FCA's Asset Management Market Study.

Glossary

AUM: Assets Under Management, the total market value of the investments that a person or entity manages on behalf of clients.

Carry/Carried Interest: A share of the returns of a fund that is received by the private capital firm managing the fund, once investor capital has been paid back and any preferred return threshold has been met.

Catch Up: A provision in a fund agreement that allows the private capital firm to receive its share of profits after the preferred return hurdle is met.

Closed-ended Funds: Investment funds with a fixed number of shares, which can often be traded, but that do not allow investors to redeem their interests and typically have a fixed size and duration.

Commingled Funds: Investment funds that pool assets from multiple investors, allowing for shared costs and diversified investments.

DC Charge Cap: The regulatory limit on the total amount of fixed charges that can be imposed on members' defined contribution pension pots.

DDQ: Due Diligence Questionnaire – A questionnaire typically used by investors to understand the terms and arrangements in place for existing investors of a closed ended private capital fund.

Default Fund: The investment fund chosen for a pension plan's contributions if no alternative is selected by the member.

Defined Benefit (DB): A pension plan where benefits are predetermined, based on salary and length of service, and not directly linked to investment performance.

Defined Contribution (DC): Pension schemes where the benefits are based on the contributions made and the investment returns those contributions have earned.

DWP: Department for Work and Pensions. The UK government department responsible for welfare and pension policy.

ESG Reporting: The disclosure of environmental, social, and governance factors that impact, or are impacted by, a company's operations and performance.

Exit: The process of selling or disposing of an investment.

FCA: Financial Conduct Authority. A financial regulatory body in the UK.

Fund Waterfall: The contractual payout sequence of proceeds generated by a fund between investors and the private capital firm.

Global Buyout: Funds that typically take controlling stakes in larger, more established private companies, or acquire businesses from the public markets, through a buyout transaction.

GP: General Partner – industry term for a private capital firm that is responsible for operating a private capital fund, and the active ownership of the fund's investments (making investment decisions, working with portfolio companies and seeking opportunities to create value and deliver returns).

Growth Equity: 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.

IPEV: International Private Equity Valuation guidelines. Guidelines that provide a methodology for private capital valuations, which is widely adopted and overlays global accounting standards. IPEV is overseen by an independent board.

Glossary

IPO: Initial Public Offering, the process of offering shares of a private corporation to the public in a new stock issuance.

IRR: Internal Rate of Return, one of the metrics typically used to estimate the profitability of potential investments.

J-Curve: The pattern of initial negative returns followed by a period of positive returns typically experienced by private capital funds due to their staggered investment cycle.

LGPS: Local Government Pension Scheme. Public pension schemes for local government employees in the UK.

Life Platforms: Integrated investment solution that offers a range of financial products and services. These are typically used by insurance, pensions, and asset management industries for buying, selling and holding a range of different investments.

Lifestyling: an investment strategy adopted in preparation for retirement which considers and protects savings from risk.

LP: Limited Partner – an investor in a private capital fund who provides capital but has limited liability, and is not involved in the management of the fund. LPs can include pension funds, insurance companies, foundations, sovereign wealth funds and others.

LTAF: Long-Term Asset Fund, an FCA authorised fund classification, designed for DC and certain retail investors to invest in assets that are typically less liquid than listed stocks or bonds.

Master Trusts: A DC pension scheme with multiple, unconnected employers, managed by a single trust with a shared governance structure.

NAV: Net Asset Value, used as a substitute for market prices in private capital to calculate typical public market measures like periodic returns.

Open-ended Funds: Investment funds that allow investors to redeem their interests and typically can issue new interests on an ongoing basis.

Permitted Links Rules: Regulatory rules that govern the types of asset that can be invested in via life platforms.

Preferred Return: A minimum threshold return that limited partners are entitled to receive before the private capital firm can participate in profits.

Private Capital: The collective term for the private equity and venture capital industry which provide investment for businesses at different stages of a company's life cycle – ranging from the early stage to mature companies – dependent on the investment strategy of the fund.

RfP: Request for Proposal, a document soliciting bids from potential vendors for a project.

RG97: The Regulatory Guide that sets out how fees and costs should be disclosed by superannuation products and managed investment products in Australia.

Secondary Markets: Markets, organised or otherwise, where investors buy and sell interests that already exist, rather than buying new interests directly from the issuing companies or funds.

TEG: Technical Expert Group. A group that provides technical expertise on specific topics.

Venture Capital: Funds that typically invest minority stakes in innovative companies with very high growth potential in their early stages of development.

Invested in a better future

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