Are DC Pension Schemes serious about investing in alternatives?

Webinar

Friday 18 November 2022

(To ask a question throughout this webinar - click the Q&A button at the bottom of your screen to bring up the Q&A board)

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This webinar will be recorded

Moderator Welcome

Melville Rodrigues
Head of Real Estate Advisory, Apex Group

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UK DC forecast rapid growth

“ DC pension schemes are forecast to continue to grow rapidly, partly as a result of auto-enrolment.

They have risen from an estimated £340 billion in assets in 2015 to £460 billion in 2019 and are expected to rise to over £1 trillion by 2030”.


FCA FINANCIAL CONDUCT AUTHORITY

A new authorised fund regime for investing in long term assets

Consultation Paper
CP21/12**

May 2021

UK pension schemes lag behind other developed economies: alternatives

- seven largest pension markets globally allocate on average 19% to illiquid assets, an increase from 7% in 2000, whereas UK pension allocations remain flat at about 7% to 8%.

- 2019 study, co-authored by the British Business Bank and Oliver Wyman with a remit from the Treasury, estimated average 22-year-old new entrant to a default DC scheme with a 5% allocation to venture capital or growth equity could achieve a 7% to 12% increase in retirement savings.

- British pension holders are missing out!

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Agenda

09.15	Introduction from our Moderator, Melville Rodrigues, Head of Real Estate Advisory, Apex Group
09.20	Presentations
	- James Monk, Head of DC Investment, Aon
	- Veronica Humble, Head of DC Strategy, LGIM
09.40	Panel Discussion & Q&A
09.55	Closing remarks
10.00	Finish

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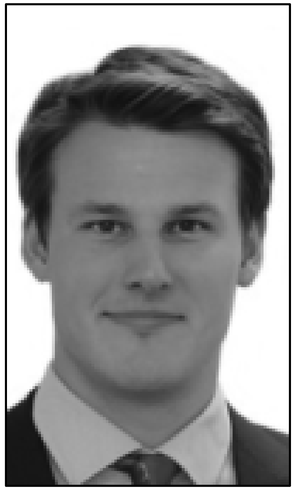
(To ask a question throughout this webinar - please use the Q&A panel to type your question to the Moderator)

Presenters

Veronica Humble
Head of DC Strategy
LGIM



James Monk
Head of DC Investment
Aon

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Aon

A DC Scheme's Perspective

Less Liquid Assets

James Monk

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Since June 2015 James has been responsible for driving Aon UK DC House Views, Delegated DC Investment Offering, Platform Selection and Investment Advice to DC Corporates and Trustees. He is also a member of the Productive Working Finance Group.

What DC Schemes are interested in less liquid assets?

	Master Trusts	Single Employer Trusts	Contract DC Providers
Market Size 2020	**£80bn, 36 Authorized MTs**	**£190bn, segmented**	**£240bn, 8 major providers**
Est. Market Size 2030	**£460bn, reduced No. viable MTs est. c. 10-20 providers.**	**£160bn, shrinking market**	**£445bn, reducing market share**
Market Drivers	Mergers / Consolidation	Significant consolidation driven by scale. Value for Money Test of <£100m, potential for increase in threshold Increased governance and regulator burden	Cost sensitivity reducing innovation Employer / Third Party Evaluator focus on Cost
Key challenges to Investment	Scale – rapidly increasing Life platform operational limitations / Conditional Permitted Links	Delegated DC offers improved liquidity management Commitment to Single Employer Trust – given 10 – 20 year illiquid investment horizon	Internal management experience in private markets
Governance	Further liquidity oversight needed, scenario modelling and ability to set limitations Advisory support in place where necessary, independence in the advisory support beneficial.	Effective governance structure already in place, advisory support in place where necessary	Greater independence needed in IGC's advice structure. Liquidity management and Conflicts of Interest, driven internal asset management need better mitigation

Hurdles

- Operational / Daily Trading Requirements
- Common Regulatory Definition of Value for Members
- Conditional Permitted Links
- Charge Cap – Perf Fees
- Treating Customers Fairly <> Daily Trading

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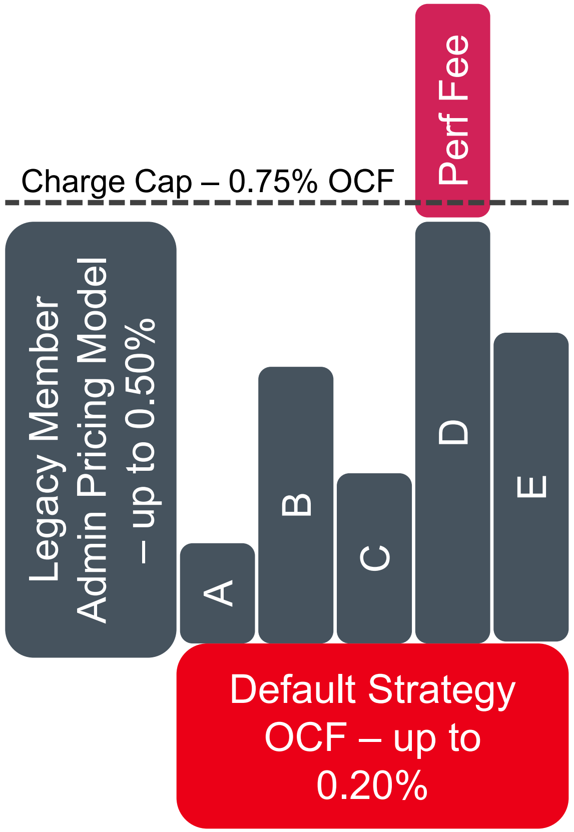
How has regulation influenced UK DC ?

Demand Side



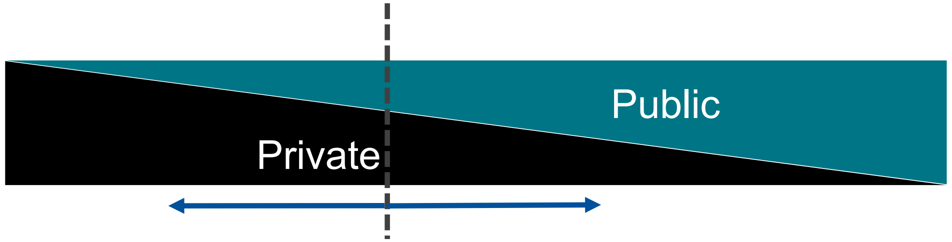
Too much focus on cost, rather than member outcomes

- Potential of performance fees too much for Consolidator strategies (the ones with scale)
  - Charge cap consultation on the way to helping with this

Consultants looking to reduce emphasis on cost onto Value for Money – common definition coming from TPR / FCA / DWP

- Competing innovations for investment budget
  - Sustainability
  - Smart Beta / Factors
  - Bond diversification

Supply Side



Price point for DC

DC Scheme Requirements

Transparency / Data

Cashflow driven from public market portfolio to enable regular cashflows but essential to provide transparency on:

- Liquidity Structure
- Scenario Modelling & Stress testing, with explicit clarity provided on scenarios when portfolio liquidity fails or when more advance notice is beneficial
- Market conditions when liquidity is restricted

DC schemes need support through transparency, particularly for their ongoing governance.

Commercial Attractiveness

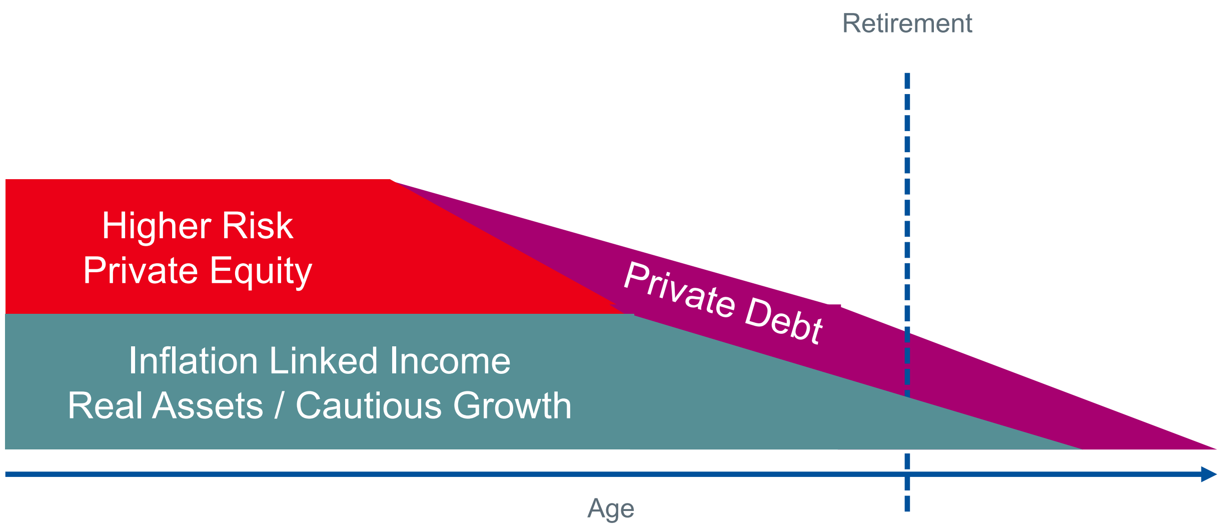
Consumer Duty & fairness principles essential (Charge Cap Consultation):

- Performance fees baked into dealing point unit prices
- High watermarks
- Frequent valuation
- Fee deals for early adopters, particularly in ramp-up

Strong sustainability stories and marketing

Consideration given to long term strategy, including scaling – potentially through GPs / Co-investments

In an ideal world, what are DC Schemes looking for?



2 schools of thought when it comes to DC Private Markets

DC has urgent need of private market diversification

- Multi Asset private market strategy
  - 60% Private / 40% Public
  - Shorter notice periods (c. 3m)
- Co-investment / Secondaries / Semi-liquid
- Sustainable broad market strategy
  - No Perf. Fee

DC should enter private markets progressively

- Spread of implementation with specialist sustainable strategies / stories
  - 90% - 100% Private
  - Longer notice periods (12m)
- Diversification of liquidity structures

Key DC Objectives

- Sustainability
- Diversification
- Inflation Linkage
- Improved risk adjusted returns

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- Past performance of any particular fund is no guide to future performance
- For funds investing in overseas markets, changes in rates of exchange between currencies may cause the value of a holding to fall. Some overseas funds invest in developing markets where arrangements in relation to regulation, dealing, liquidity and custody may be less secure than in the UK. Such funds can therefore carry greater risk
- Funds that invest in real property may carry additional risks in that the property element can suffer from problems with liquidity due to the delays and expenses that can arise with property transactions. This may result in increased volatility and, in extreme circumstances, can delay the encashment of investments in these funds
- Some cash and/or deposit funds do not actually only hold cash on deposit; they can be money market funds that invest in different types of securities within the money markets. Such funds are potentially more volatile than funds that hold cash on deposit. As such, members should be aware that, in certain economic conditions, even the value of these funds may fall and therefore the value of their capital is not guaranteed
- A lifestyle strategy may not be appropriate for members considering unconventional forms of retirement benefits, such as income drawdown. Therefore, it is recommended members seek appropriate advice when taking benefits to ensure they fully understand the consequences of their actions

NOVEMBER 2022

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Illiquids in DC

Veronica Humble

Head of DC Investments, LGIM

Range of liquidity

Liquidity provided by the market

Liquidity provided by the fund manager

Liquidity managed by the platform provider/DGF(diversified growth fund) manager

No liquidity for the lock-in period

more liquid → **less liquid**

Company shares

Investment trusts

Unit trusts, NURS (non-UCITS retail schemes)

Fund blends

Fund blends with illiquid components

Illiquid funds

regular contributions → **no cashflows in**

Illiquids in DC

Real Estate | Infrastructure | Private Equity | Private Debt

Key requirements for DC schemes

- Focus on growth assets
- Focus on cashflows in – DC schemes are cashflow positive, assets in retirement will reach scale only in 10-15 years
- Ease of implementation

Why should DC schemes allocate to illiquids?

✓ Illiquidity premium
✓ Increased diversification

What are the common constraints?

χ Liquidity constraints
χ Cost constraints
χ Operational constraints
χ Complicated implementation

Key drivers

✓ Aim to improve risk adjusted returns
✓ ESG/climate
✓ Regulatory/government encouragement

Gatekeepers

- Investment consultants
- Platforms/blending capabilities
- Investment capabilities

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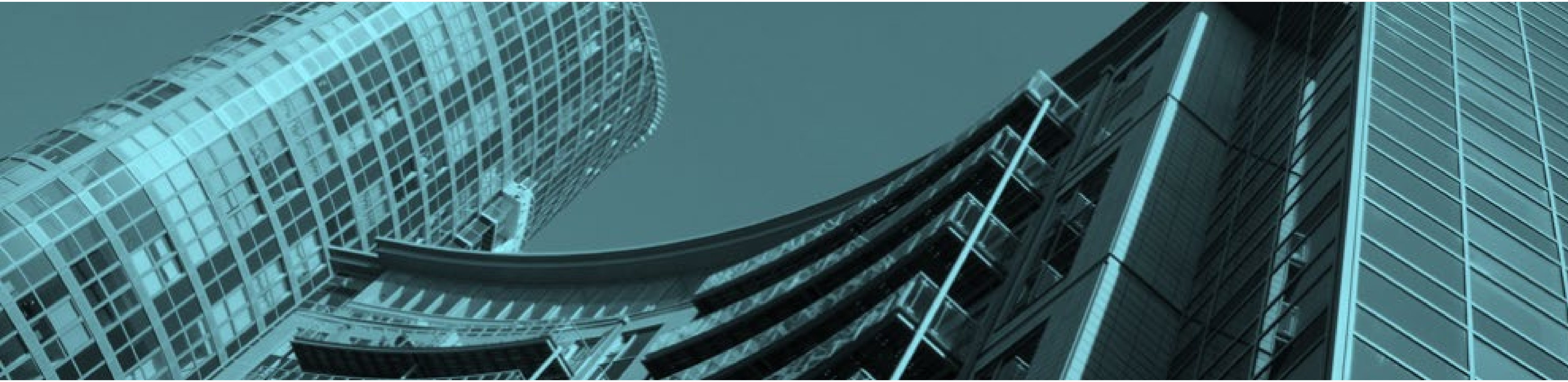

Panel Discussion & Q&A

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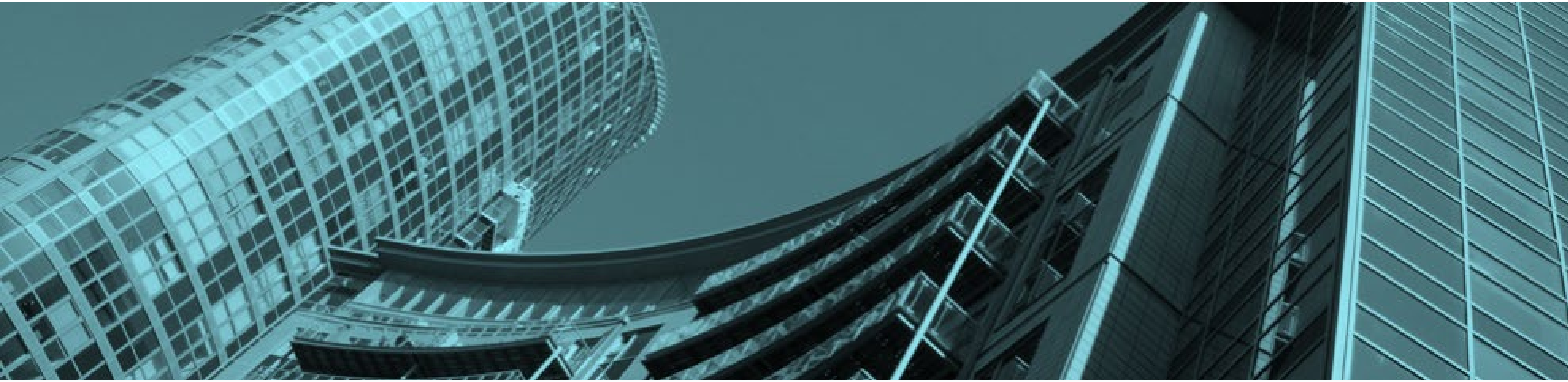

Thank you for joining us

The recording and slides will be available on the AREF website and emailed to members later today