



Laura Blows
Editor
Pensions Age

SCOTTISH WIDOWS

Mithesh Varsani
Head of investment solutions,
Scottish Widows

Private markets have been a major focus for the UK workplace pensions industry in recent years. I imagine this was part of the thought process behind Scottish Widows' launch into private market investment solutions for workplace pension funds?

Mithesh Varsani: Private markets typically come with higher hurdles, such as appetite, understanding, resourcing and costs, but those have started to come down. Access to certain asset classes is now more widely available, and adoption and appetite within the industry have picked up.

However, when we think about the different customer cohorts we have, there are those who, depending on scheme size, appetite, and demographics, may not be ready to go 'both feet in' to private markets. At the other end of the spectrum, there are those with the right governance and understanding to support investment in these new asset classes.

So, we asked: how do we help customers along that journey?

We recently launched our Lifetime Investment Plus strategy, which allocates 10-12.5 per cent to private markets, and our Lifetime Investment Extra strategy, allocating 20-25 per cent, which allow us to integrate private markets in a way that supports where customers are right now

Incorporating private markets into DC funds

Laura Blows discusses the role of private market investment within pension funds with Scottish Widows' head of investment solutions, Mithesh Varsani

in their decision-making framework.

For us, private markets are not one-size-fits-all. We've taken a measured approach to integrating them into our lifetime strategy.

So, you mentioned the increased appetite and focus on private markets, but why is that? What benefits are you seeing?

Mithesh: If you invest in global equities all companies via an index, it might include around 9,000 companies. But if you look globally, there are over 140,000 private companies with revenues over \$100 million.

DC members just aren't accessing those revenue streams. Having access to different companies and different revenue streams allows for diversification.

However, private markets aren't just one asset class, they include private equity, private credit, infrastructure, and natural

capital. Each have their own different risk and return characteristics, giving us a wider toolkit for managing a member's journey.

DC members have that long-time horizon in terms of being able to invest. So if you're locking up your capital then you want to be rewarded for that. So there's an illiquidity premium.

Private markets provide real economic exposure to real assets, physical assets, such as renewable energy. These assets can provide resilience and contractual cashflows, which is especially important later in life, and can help with inflation linkage.

We also recognise that there's early startups or businesses that can prove themselves, but the capital hasn't been provided for them to scale up. Private markets give members access to these startup and mid-market growth opportunities they otherwise

wouldn't have.

If we think about some of the strategic changes that we're going to be going through, in terms of the energy transition, or thinking about climate, being able to invest in new technologies that help address those is usually putting money into new technologies. However, it could also mean things like social housing. With private markets, you have a greater degree of ownership, so when it comes to things like engagement or navigating the business to recognise their broad responsibilities, you can do that.

➤ These benefits have always been there, but fitting private markets into DC portfolios has typically been considered a challenge. How do you address this?

Mithesh: The obvious challenge is liquidity. Members may want to access benefits, and private assets can't always be realised quickly. But liquidity is also broader than that; it's about cash management across the lifecycle of private market investments.

In a portfolio setting, it's recognising that if you've got a portfolio of these different companies or asset classes, you have to be able to both manage liquidity from the end member perspective and put that money to work as well.

So liquidity is an important part of that puzzle, but so also is the shape and size of the private market exposure.

There is access via secondaries, where you can take stakes off other limited partners. And there's things called co-investments, and direct investments, and all of these mean that the way in which you structure private markets become important.

You also need to have that network to find those companies that you can be able to finance. If you're investing or building airports, bridges or infrastructure, you've got to have the right expertise that understands those sectors, so you go from developing an asset to then it becoming operational.

Finally, dispersion of returns is wider in private markets and therefore manager

selection risk is significant. So, it's not one size fits all. Providers must understand and manage these nuances to harness the benefits effectively.

➤ It sounds like a delicate balance, overcoming challenges while maximising benefits. How does Scottish Widows manage that?

Mithesh: The first thing to consider is structure. We benefit from not being a direct asset manager, so we have complete focus on finding the best experts when it comes to thinking about private markets. We operate an open architecture approach, which we think is really valuable for recognising the different spread of outcomes. We wanted a structure that provides access to primaries, secondaries, co-investments.

We wanted to also have our own bespoke mandates as well, so we opted to sponsor our own Long-Term Asset Fund (LTAF) umbrella structure. So we have launched two LTAFs, giving flexibility and governance control.

Second, we focused on the member journey.

Because private markets encompass a range of different asset types, it enables us to focus on maximising growth during the accumulation phase by allocating to assets like private equity, venture capital, and infrastructure equity. We can allocate to private equity, venture capital, and infrastructure equity.

And then as members start moving towards that later life, into pre-retirement, and through retirement, we shift toward private credit and income-generating assets aligned with preservation and inflation linkage.

And so that's why we have our two LTAFs – a growth focus LTAF, which has got the more 'octane' asset classes, and then a more diversified private credit for those closer to retirement.

I think that allows us to really harness private markets for members to match to where they are in the journey.

Third, liquidity management. If you focus too much on having liquidity, you

could inadvertently put too much liquidity within the structure at the wrong time. So what we wanted, as part of having our own LTAFs, is that transparency of cashflows.

Lastly, we're part of Lloyds Banking Group as well and within the group, we've got Lloyds Development Capital, where they're helping businesses throughout the country in terms of providing equity financing. We have Lloyds Living, which is playing a big role in terms of social housing. We also do lending through the corporate bank, and also our shareholder assets team, as well as already investing directly into private credit.

We're really looking forward to bringing those four different facets to tackle private markets for our clients.

➤ How do you help align investing in private markets with other concerns, such as responsible investing, or the importance of member choice?

Mithesh: Responsible investing is standard for Scottish Widows.

Our exclusions policy applies. We conduct due diligence on managers' processes, assess Sustainable Development Goals alignment, and require transparency in reporting.

Private markets allow greater ownership and engagement, so we're really excited about how we can deliver responsible investing within that.

And then, regarding member choice, that was a big part of why we announced our Scottish Widows lifetime investments strategies. These are a way for members to incorporate private markets, if they wish, wherever they are throughout their retirement saving journey.

This is an edited summary. To watch the video in full, please visit [pensionsage.com](https://www.pensionsage.com)

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