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Private markets roundtable

MODERATOR:
- Mercer head of investment proposition, Ben Lewis

PANEL:
- Mercer alternatives investment director, Daisy King
- Mercer head of DC client development, Adele Ray
- Mercer master trust lead, Tracie Denson
- now:pensions director of investments, Martyn James
- Future Growth Capital head of portfolio strategy and portfolio manager, Ed Studd
- XPS Group DC investment partner, Callum Stewart
- Isio senior DC investment consultant, Adam Fisher
- Hymans Robertson DC investment consultant, Michael Ardill
- Zedra professional pensions trustee, Sam Burden
- PwC pension specialist, Paul Woods
- PwC DC master trust advisory and south regional employer covenant leader, Minesh Rana

A clearer path to private markets

Attendees explored how private markets would be a key evolution in the coming years and the important factors to consider when building an allocation

Experts from across the industry gathered for Mercer's Private Markets Roundtable, which kicked off with a presentation from Mercer alternatives investment director, Daisy King, and Future Growth Capital head of portfolio strategy and portfolio manager, Ed Studd. They highlighted three key factors as important when building a defined contribution (DC) private markets allocation: 1) getting exposure to the highest returning private markets asset classes (private equity and infrastructure equity) 2) managing liquidity carefully, given the potential for cash to act as a drag on returns and 3) working with capable fund managers, given the significant dispersion that has been evidenced between the best and worst managers.

Following the presentation, the roundtable discussion opened with Mercer head of investment proposition, Ben Lewis, noting that the conversation around private markets has moved on from 'should we do it?' to 'how do we implement it best?' Lewis posed a question to the room about the approach that providers are taking to introduce private markets.

"There's a variety of options on the table here. We've seen some launching a single best idea solution versus others in the market launching premium defaults. Is there a preference between those different approaches? What do you think that could mean for the market in the coming years?" Lewis said.

In response, XPS Group DC investment partner, Callum Stewart, said he has a "strong preference" for a single best idea solution. He emphasised that offering choice is effectively placing a "lottery on outcomes" for members and employers, which he finds unfair, especially since most of the expertise lies with the providers and they should stand behind their convictions.

In addition, Isio senior DC investment consultant, Adam Fisher, argued that employers may face significant challenges if given the option to choose 'core' and 'premium' options with and without private markets allocations, given the limited experience and expertise in this area for governance committees compared to trustee boards.

"I believe many employers may currently lack the dedicated time and specialised resources to make such decisions confidently," Fisher stated. "As a result, many employers are likely to adopt a more cautious approach, remaining within familiar, more liquid investment strategies."

The role of employee benefit consultancies (EBCs)

The attendees went on to consider the

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role of EBCs, specifically focusing on how to approach conversations with clients about solutions that may carry a higher cost. They also considered whether adequate support and guidance are available to facilitate these discussions effectively.

Zedra professional pensions trustee, Sam Burden, said it is becoming challenging to evaluate default options, particularly with the inclusion of private markets and alternatives, as such assets require their own analysis.

"Be it trustee or employee, you're going to become very dependent upon advisers to help you assess default investment options both at selection and ongoing review," Burden added.

Fisher also cautioned that the industry seems to be assuming that higher allocations to private markets simply lead to superior outcomes.

"While private markets are often discussed as a single category, they in fact encompass a broad spectrum of assets," he explained. "Even within infrastructure or private equity, the choice of sub-asset classes can significantly influence outcomes. It is therefore essential to consider the details of implementation, including asset allocation, manager selection, and the investment team's experience. In my view, implementation is a more critical determinant of success than allocation alone."

PwC pension specialist, Paul Woods, stressed that the "timing of the value for money (VFM) framework introduction could be really unhelpful too, because it could lead to conflicting messages".

Picking up on the framework, Stewart agreed and added that VFM "creates an environment where good can easily be good enough".

"I think that's a problem. Are we looking for good or very good? We are looking for the best outcome. There are two shades of green. That's sending the wrong message to the industry and creates the environment where a multi-outcome, multi-default approach can survive, so a large enough provider can," Stewart said.

"EBCs, trustees, and governance committees have all got really important roles to perform. It's nice to hear Mercer's approach, where you're focusing on the single best idea approach and the considered build up. Not all providers are approaching it that way. We all, in our own ways, have an opportunity to influence the direction. We need to try to find a way to plug the deficiencies of the framework effectively."

Fees

The conversation then moved on to fees, with Mercer head of DC client development, Adele Ray, saying: "Amongst all providers, we're going to see a ramp up in fees as the allocation to private markets increases. Despite all being very focused on value, there has been a race to the bottom on fees from a provider perspective. We can't deny that, but that has to change to increase the allocations to private markets."

She also emphasised that providers with multiple defaults can't continue, as it is creating more confusion in the market.

PwC DC master trust advisory and south regional employer covenant leader, Minesh Rana, questioned if over time people will shift their focus from gross costs to net returns.

In response, Fisher emphasised the need for greater education in this area, particularly for non-investment specialists.

"It is understandable that those without an investment background may focus on fees, assuming that lower costs are preferable," Fisher said. "In the context of passive investing, where portfolios track broadly similar indices, this approach may be reasonable. However, private markets represent an entirely different and more complex investment landscape."

Hymans Robertson DC investment consultant, Michael Ardill, stressed: "It is two very different conversations. Selecting a new provider versus your provider saying to you, 'We are going on this journey' *[to increase the private markets allocation]*. You get two very different reactions."

Allocations and experience

now:pensions director of investments, Martyn James, noted that before now:pensions was acquired by Mercer, it looked at building its own private markets solution.

"But when we were looking at building it out, we couldn't have invested in a portfolio with as high as 50 per cent in private equity, because simply we couldn't afford it. We didn't have the scale to demand the commercial terms with the partners that we were looking at," James explained.

"When we spoke to Mercer, who were going on a parallel journey, and we were able to combine that scale, it was at that point that we realised that if we were to combine assets, move into the same kind of vehicle, we could achieve a better asset allocation for our members. There's talk in the market about if scale helps, and this is a proof point almost immediately

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with the combination of the assets of two master trusts that scale did help us. And because we can have more in private equity, we expect higher returns for members in the future."

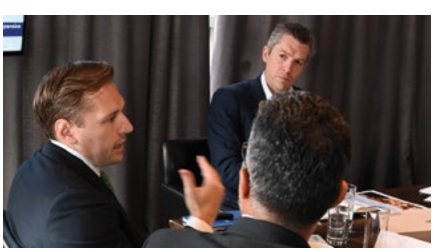
Given this perspective on the advantages of scale, the discussion then moved on to consider how EBCs play a critical role in optimising these benefits. Specifically, thorough research into various asset classes and regarding the diverse landscape of private equity managers.

Woods contributed by highlighting the complexities surrounding leverage in these funds. He noted that while there may be a top-level limit on borrowing for long-term asset funds (LTAFs), often set at around 30 per cent, the actual operational limitations are less clear. He emphasised the need for deeper insights into the extent and impact of leverage, as well as other leverage-related metrics in these funds.

Ardill, however, suggested that it goes wider than leverage.

"Leverage is part of it, but it is also the transparency in how comprehensive the reporting from any DC provider can be. It's one thing to say private markets equal higher returns, but you've got to peel all the way down to the bottom level. Can you do that, and can you provide that visibility on an ongoing basis as well?" he said.

Adding to the debate, Fisher said: "We constantly ask questions to the providers. I think providers and EBCs



need to work together closely so they can provide the information we need to make these decisions. Some providers are good at providing lots of information, while others are more guarded."

"I think it will be a journey in that respect over the next few years", James said. "I don't think there'll be a lack of willingness to provide the information. With this LTAF, we've just made our initial commitment and first drawdown. We just started investing and will work on our own internal reporting to get that information. What will be challenging is if there's not a common set of reporting requirements."

Rana highlighted PwC's work with UK Private Capital to bring together the private capital and pension industries to explore how best to facilitate greater pensions investment into private capital.

"We looked at a range of factors, including how best to set out the investment case and thinking through the presentation and assessment of costs across different asset classes," he continued. "UK Private Capital has since taken forward a number of recommendations, including on the investment case and the presentation of costs, working closely with the Pensions and Private Capital Expert Panel."

Expanding on this, Ray then raised a question on the possibility that the VFM assessment might encourage herding among providers.

Stewart expressed that herding might occur around the implementation of a strong strategy, suggesting that the VFM framework sets conditions where "good is good enough".

Fisher also identified a broader trend towards increased homogeneity in default DC strategies.

"There has been a significant shift towards growth-oriented portfolios with shorter de-risking periods," he observed. "As a result, there is limited differentiation between most default offerings. Private markets may therefore provide an opportunity for providers to distinguish themselves."

UK vs global

The panel then delved deeper into the geographical footprint of portfolios and how clients should think about that UK versus global exposure.

Fisher expressed scepticism regarding mandated targets. "I do not see a strong justification for constraining portfolios with specific allocation requirements to the UK," he said. "In my view, the responsibility lies with the government to create a compelling investment environment or introduce incentives that make UK assets more attractive. In many cases, portfolios may naturally achieve a modest allocation to UK assets without such mandates."

Lewis highlighted that Mercer's portfolio has no hard targets for its UK exposure level.

"That was one of the conversations we were keen to have with the management team, which was to make sure that there was comfort in that approach," Lewis explained. "The UK is 10 per cent of the global private markets' opportunity set, and if the portfolio managers find the right deals, then we go in excess of that 10 per cent – then fantastic. Equally, if we end up with 5 per cent because there aren't the right deals, then that reflects the opportunity set available at the time we were deploying."

Rana added: "There's a need for the UK to have a compelling investment case and for the opportunities to be attractive to pension funds. The university sector is an area where there could be more scope for pension funds to invest in Private

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Capital. For example, are UK pension funds making the most of the innovation coming out of the Oxford/Cambridge corridor and other major universities?"

However, he acknowledged that one of the challenges is the disparity between the scale at which funds need to be deployed by some pension funds and the investment required by some of the scale-up businesses.

Engagement

The conversation then turned to engagement, and the attendees spoke about whether members care about where their pension is invested or simply the size of their pot. There was also debate on responsible investment and definitions.

Woods emphasised: "I think the challenge is that the industry's partly gone down that route of giving members noise around responsible investing; it seems to be quietly just disappearing."

Burden, meanwhile, said it is just as important to engage the employer, who can ensure default investment options are aligned to the employer's and employees' values, as "the employer is, after all, investing a huge amount of contributions on behalf of members".

Additionally, Rana pointed out that governance and oversight structures at pension funds will need to evolve as pension funds gain scale.

"The governance structures that you need for a £1 billion pension fund are different to what you may need for a £10 billion pension fund or a £100 billion pension fund. That development needs to be thought through and managed as pension funds become bigger," Rana said.

Mercer master trust lead, Tracie Denson, said in her experience over the past couple of years, there has been a ramp up in curiosity and an uptake in people who want to be educated about investments.

James warned that: "The biggest risk in private markets investing being a success in the master trust industry is if there is a failure from one of the master trusts, whether that's an asset that goes wrong or just general poor returns. And I worry that members and the industry might see that, and it impacts the general positive direction we are on."

Ardill also noted the sensitivity of some of these investments for members.

"When we talk about things like housing, that's personal and emotive for a member, and care needs to be taken that you manage the risk of drawing a negative correlation between where the pension's invested and the life they're living on a day-to-day basis as well," he said.

"In some ways, you hope they don't look at the value of their pension pot too frequently, and they are in a default, letting it run on, and maximising their contribution structure," Ray added. "It's about being engaged but at the right time so that they don't make the wrong decisions when it matters most to them."

Final thoughts

As the discussion wrapped up, the focus shifted to the significant challenges and opportunities presented by private markets, particularly regarding their long-term impact on member outcomes.

King highlighted the importance of partnering with experienced managers who have a proven track record in private investment, noting that the ultimate goal should be to ensure high-quality outcomes for members.

Alongside this, Ray emphasised that "private markets are really going to refocus the value needed to drive long-term outcomes for members. It's going to be an evolution rather than a revolution, and I'm intrigued to see what the market looks like in 2030 and beyond".

Fisher also suggested that private markets will play an increasingly important role in the evolution of DC investment strategies. "Over the next decade, private markets are likely to have a substantial impact on DC investing," he concluded. "There will likely be clear winners and losers among providers, and it will be interesting to observe how this landscape develops over time."

Finally, Studd noted: "There are a lot of fantastic opportunities in private markets. And the gap between doing it well or not all comes down to how you implement. It's not just which asset classes are in your mix, it's within those asset classes, what areas of the market you're targeting, which managers are in the portfolio, and then the whole portfolio management piece on top.

"I would underscore the importance of really digging into how these portfolios are being implemented and understanding what's happening under the hood. That will be a key contributor to how they ultimately perform."

Lewis closed the discussion, reflecting that private markets would be a key evolution in the coming years, with Mercer inviting further conversation about its differentiated approach with EBCs, trustees and clients.

Contact Adele Ray at Mercer to learn how their service can support your scheme.
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