PORTFOLIO INSTITUTIONAL NOVEMBER 2024

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DEFINED CONTRIBUTION:

THE CHALLENGES AHEAD

BACKING BRITAIN
Local assets for local people

CLIMATE CHANGE
A human rights issue?

DC ROUNDTABLE
Alternative thinking

Issue No. 138 | www.portfolio-institutional.co.uk | Independent analysis for institutional investors

DEFINED CONTRIBUTION: THE CHALLENGES AHEAD

Albert Henry Woolson's passing in 1956 marked the end of an era.

The 106-year-old was officially the last survivor of the American Civil War. Indeed, his death came almost 100 years after the first shot of the conflict was fired.

Despite having a keen interest in history, there was one thought that came to mind when I read his story: someone had to pay his pension for a war he fought in when he was a teenager.

Although the cost of his long retirement was covered by the government, corporates face similar challenges in the UK. We are, on average, living longer and someone has to pay for that.

And it seems that fewer employers are. The growth of the defined contribution industry is putting pressure on workplace pension providers to build long-term portfolios that reflect the decades of contributions members have made.

There are many challenges for those managing assets in DC land, and this month's cover story looks at some of the main ones (page 16).

The DC theme continues from page 26 as we bring a number of trustees and the asset managers investing on their behalf around a table to discuss how they are building portfolios of illiquid assets.

The government's push for workplace pensions to invest in smaller domestic companies and to fund the upgrade and repair of the country's infrastructure is a theme we continue on page 46, where we put British assets under the microscope.

Another issue impacting pensions is the Autumn Budget. We look at what it could mean for the markets from page 22.

Pensions, of course, are no longer simply about yield. There is a growing desire by some members to use their capital to also build a greener and fairer world. From page 42, we look at how pension schemes are promoting higher standards of human rights and ask if it is more of an environmental than a social issue.

Elsewhere, we sit down for a chat with Smart Pension's James Lawrence to hear about how he is building the master trust's brand, while Leanne Clements of People's Partnership explains how stewardship could be more effective.

We hope you enjoy the edition.

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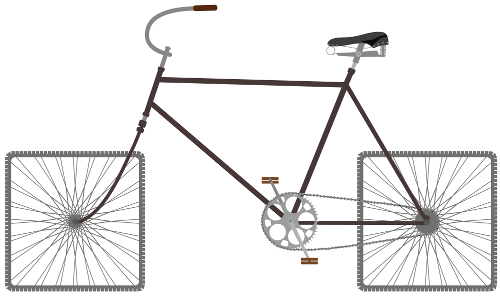

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PE SHINES DURING MARKET SLUMPS

The asset class has outperformed public markets during each of the past five financial crises. *Andrew Holt* reports.

For those wanting pension funds to invest more in private equity, a new report showing the asset class consistently outperforming listed markets during the largest market crises of the past 25 years will be music to their ears.

This has been revealed by Schroders Capital, which undertook a study of private equity performance within a broad analysis of the past since 1999.

This was a period that saw five major financial crises: the dotcom crash; the global financial crisis; the Eurozone crisis; Covid; and the return of inflation.

Amid this turbulence, private equity managed to deliver impressive absolute and relative performance and outperform public markets, according to Schroders Capital.

Putting numbers to this case, global private equity outperformed the MSCI ACWI Gross index during each of the major disruptions with an average annualised excess return of 8%, according to the research.

In addition, when comparing performance to the S&P 500 Total Return index, global private equity also consistently outperformed during all five crises, with an average outperformance of 4%.

And the maximum quarterly drawdown over the five periods averaged -18% compared to the -31% drawdown of the MSCI ACWI Gross index.

Even in the depths of the dotcom crash of 2000, where private equity was challenged due to its exposure to early-stage technology companies at the heart of the bubble, it still fared better than public markets.

And amid the uncertainty surrounding Covid, private equity achieved annualised returns of 18%, while public markets delivered only a 2% return.

Furthermore, global private equity has delivered a compound annual return of 12% during the past 25 years, outperforming the MSCI ACWI Gross, MSCI World Gross and S&P 500 Total Return indices.

Resilience

The key driver behind this outperformance has been the resilience of private equity during crises, the research said. Private equity delivered an annualised excess return of 8% during the five crises and half this during undisturbed periods.

Interestingly, all private equity strategies performed consistently well throughout the eurozone crisis, including in Europe.

However, in each of the other crises, diversification was key to achieving resilient returns.

Furthermore, small/mid buyouts were the best performing strategy or among the best performing strategies in four of the five crises.

There has been, in some crises, divergence of performance within private equity. During the financial crisis, global private equity declined by 6% per year, outperforming the MSCI ACWI Gross index, which fell by 9% annually.

Small/mid buyouts were the least impacted, dropping only 4% per year due to their lower reliance on leverage at a time of tight liquidity. In contrast, large buyouts were the worst performing strategy, with an 8% annual decline.

Additionally, private equity returns in Asia and the rest of the world were negatively affected by weaker domestic growth, particularly impacting buyouts.

And notably, after a bumper 2021, venture capital/growth became the worst performing strategy in 2022, declining 20%. However, this was still a superior performance when compared to the Nasdaq Total Return, which was down 32%.

In four of the five disruptions were characterised by boom-bust scenarios. Venture capital/growth was the best performing strategy throughout the dotcom bubble ahead of the crash.

However, after the collapse in technology valuations, it became the worst performing strategy by the end of the disruption.

Similarly, in the lead up to the financial crisis, buyout funds raised substantial amounts of capital, and many small/mid funds ballooned into large funds.

However, when liquidity dried up, large buyout funds with highly levered portfolio companies experienced significant drawdowns and negative returns.

Private equity lag

And any comparison of public and private equity returns is influenced by valuation methodologies, as there is often a lag before private equity valuations are updated, noted the research, with private equity valuations experiencing a one-quarter lag to public markets.

To account for this, Schroders Capital extended the returns calculation window by an additional quarter.

It should also be noted that the private equity industry changed considerably from the dotcom crash in the early 2000s to the return of inflation in 2022 in terms of regulatory and accounting considerations, which could impact historical comparisons.

The financial crisis served as a catalyst for introducing more rigorous fair value assessment practices, potentially resulting in private equity valuations having had less frequent mark-to-market assessments prior to that period.

Nils Rode, chief investment officer at Schroders Capital, said: “This analysis highlights private equity’s potential as a robust component of investment portfolios, especially during periods of economic uncertainty.”

LATEST BANK OF ENGLAND INTEREST RATE CUT LEAVES INVESTORS CALM, BUT MUDDIES THE OUTLOOK

Despite a muted response in the markets, the latest rate move offers some optimism. *Andrew Holt* reports.

The Bank of England's (BoE) November interest cut to 4.75% – the second reduction this year – was met with calm from investors, while offering some opportunities.

"Gilt markets have taken the BoE's decision to cut rates by 25 basis points in its stride, with little market reaction," said Mohammed Kazmi, chief strategist and senior portfolio manager at UBP.

"This comes in stark contrast to the price action observed over the past couple weeks given the event risk that came from the domestic budget and the US elections," he added.

Kazmi also observed that while the bank significantly raised its growth and inflation profile for the UK in 2025, as a consequence of the budget, much of this was already in the price given that the market expects the BoE to cut rates to the highest terminal rate within the G10, at around 4%.

The situation does though present bond opportunities. "With government bond yields globally having now corrected over the past month towards more reasonable levels and credit spreads continuing to find support from the soft landing backdrop, we believe it presents an opportunity for investors to take advantage of the attractive yields on offer within the asset class and with the election clearing event having now passed," Kazmi added.

Bullish voices

In this environment, he has a "preference for the higher income segments of the market, such as high yield, as we anticipate for the default rate cycle to remain benign and the AT1 market given robust banking fundamentals."

There can be no doubt that Rachel Reeves' budget hung over this rate decision, and possible future decisions to come.

For Laith Khalaf, head of investment analysis at broker AJ Bell, the prospect of more cuts is no longer clear. "The market is still pricing in another [UK] rate cut either in December or February, and then another one by May 2025.

"There are some more bullish voices out there, including Goldman Sachs who have forecast the UK base rate to fall to just 2.75% by next autumn. The fact the decision to cut rates was almost unanimous will put some powder in this argument," Khalaf said.

"But if Donald Trump pushes ahead with a restrictive trade policy, that would really put the cat amongst the pigeons when it comes to UK inflation and interest rates."

Cut acceleration

Although ING developed markets economist James Smith predicts the BoE will have managed six more cuts by next autumn. "If services inflation continues to fall more meaningfully next year, as many of the surveys seem to indicate, then we are still likely to see rate cuts accelerate," Smith said.

"Remember, markets are pricing fewer than three rate cuts from here on in," he added. "That would leave UK rates more than two percentage points above the European Central Bank in a year or so.

"We don't think that sounds particularly realistic. Our view is that rates will be cut at every meeting from February until they reach 3.25% next autumn."

And Jamie Niven, senior fund manager at Candriam, warned: "We continue to believe that, certainly on a relative basis, market pricing for the terminal rate [the long-term target] in the UK is too high."

In its announcement, the bank said the chancellor's £70bn of additional spending, backed by higher taxes and borrowing, is expected to add about 0.5% to headline inflation and 0.75% to gross domestic product.

Research group Capital Economics wrote in an investor note: "While cutting interest rates from 5% to 4.75%, the Bank of England implied that the Budget means rates will continue to fall only gradually.

"We agree and due to the Budget, and not the US election, we have concluded that rates will fall slower to only 3.5% in early 2026 rather than to 3%. This still implies that rates fall below investors' expectations of a low of 4%."

Unknown risks

But for Michael Metcalfe, head of macro strategy at State Street Global Markets, what was most interesting about the bank's statements was what was missing.

"The BoE's projections are based off market implied interest rate assumptions taken in the second half of October, so before the Budget, but they still saw inflation falling to target," he said. "The implication is that market move up in interest rate expectations since the Budget is excessive and that more cuts are possible.

"A tendency that will only be further encouraged if another risk not noted in the November policy report, a US universal tariff on exports, is realised," Metcalfe added.

Ahead of the BoE's next rate decision, a range of data focusing on different areas of the economy will become available for investors and others to make a call on the wider economic situation.

"We will get multiple growth, inflation and labour market reports to watch ahead of the Bank's December decision," said Sanjay Raja, chief UK economist at Deutsche Bank.

PEOPLE MOVES

This month's round-up of the latest recruitment news in the institutional investment space starts with **The BT Pension Scheme**, which has welcomed two member-nominated trustee directors to its board.

Ricky Henderson and **Pauline Rourke** were selected as directors of the £35bn pension scheme by the Communication Workers Union and the National Federation of Occupational Pensioners.

Rourke (*pictured*) replaces Beryl Shepherd, who has retired after 15 years at the scheme, while Henderson succeeds the late Andy Kerr.

Brunel Pension Partnership has started the search for a new head of investment after **David Vickers** announced he will step down from the pool next summer after four years.

Elsewhere, **Priti Ruparelia** has joined the board of the £4bn **SEI Master Trust** and also takes a seat on its investment sub-committee.

The trustee director and head of defined contribution at Independent Governance Group has 25 years of pensions experience. This includes establishing DC pension schemes and transitioning them into master trusts.

Ruparelia has Blackrock and Aegon on her CV as well as Legal & General Investment Management, where she led the DC client relationship team.

Caroline Escott has become chair of the investment and sustainability committee of the **Standard Life UK Master Trust**.

Escott, who is also a senior investment manager at Railpen, has been a trustee director of the £10bn master trust for almost five years.

Best Trustees has unveiled its fifth professional trustee recruit of the year after **Alison Creasy** joined the professional trustee firm.

A 30-year veteran of the pensions industry, she started as a consultant and an actuary before becoming a professional trustee in 2012. Creasy specialises in preparing schemes for insurance de-risking transactions.

Finally, **Bella Landymore** and **Sarah Teacher** have been named as joint chief executives of the **Impact Investing Institute**, while **Kieron Boyle** becomes chair.

He replaces **Elizabeth Corley** after nine years, who becomes chair emerita.

Together they lead a strategy to mobilise £1trn of capital for the benefit of people and planet.

CALENDAR

Topics for upcoming *portfolio institutional* events*

05 March 2025
Private markets conference

15 May 2025
portfolio institutional Awards

02 October 2025
ESG Club conference

*Subject to change

NOTICEBOARD

Border to Coast has launched a direct UK real estate investment fund.

The local government pension funds of Tyne and Wear, Cumbria and South Yorkshire have collectively moved 65 assets into the proposition, which include offices, retail, care homes, student housing and warehouses across the UK.

The fund targets CPI-plus 4% over rolling 10-year periods, net of fees.

The intention is to double the size of the fund to more than £3bn in the next five years.

Abrdn will advise on the implementation of the investment strategy.

Also launching a new property fund is **Access**, a £45bn pension pool for 11 local authorities.

The £100m Impact Real Estate strategy focuses on decarbonising buildings and marks another step by the pool into private markets. **Orchard Street** will manage the fund.

Brunel Pension Partnership has agreed a 20-year deal to buy renewable energy from the UK's largest solar park.

The pool backed the inflation-linked agreement with Llanwern, a 75MW solar farm in Wales, through Next Energy Capital's NextPower UK ESG fund, which sits within its renewable infrastructure portfolio.

The Royal Mail Pension Plan launched the UK's first collective defined contribution (CDC) scheme in October and has appointed **Blackrock** as its investment manager. The asset manager has had an outsourced chief investment officer (OCIO) arrangement with the scheme since early 2023.

The Wiltshire Pension Fund has hired Redington as its strategic investment adviser.

The consultancy will advise the £3.5bn pension fund on all areas of its investment strategy, with a particular focus on making its portfolios more sustainable.

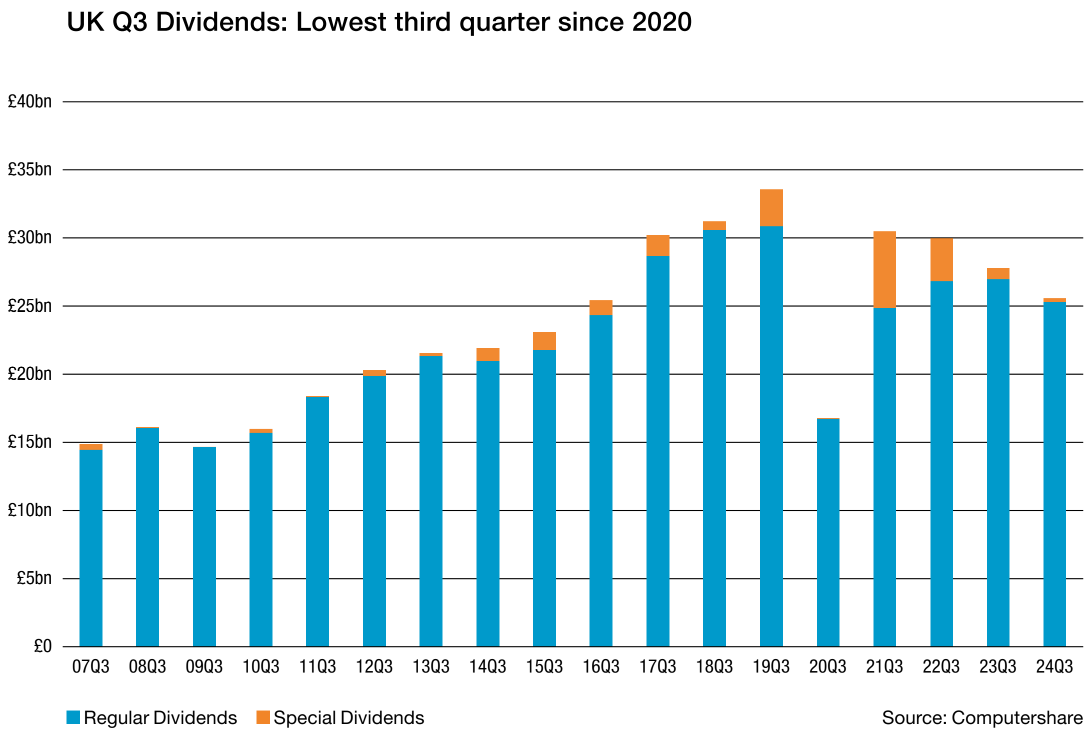
Building materials group **Wolseley** has chosen **The Aon Master Trust** as the new provider of its defined contribution pension scheme.

The master trust has taken responsibility for the £230m scheme, which serves more than 13,000 members who have worked, or currently work, for the plumbing, heating, cooling and infrastructure merchant.

Finally, **Just** has agreed a £7m buy-in with the trustees of the pension scheme sponsored by engineering-focused research and development firm **Armfield**.

The deal, which completed in March but not announced until October, protects the benefits of around 40 members of the scheme.

THE BIG PICTURE: UK DIVIDENDS PROVE DEEPLY DIPPY



Shareholder cash returns slump as miners cut their payments, but this is not the whole story, finds *Andrew Holt*.

UK dividends dived 8.1% to £25.6bn in the third quarter, forcing financial services group Computershare to revise its expectations for the year.

This made it the lowest third quarter for dividends since 2020, when many companies cut their payments to preserve cash.

This latest decline reflected steep cuts in the mining sector – as well as a stronger pound, unusually low special dividends and large share buyback programmes.

What is revealing within the latest data is that median growth in dividends per share was 4.5% – a little slower than in previous quarters but one that suggests growth across the wider market was better than the top-line numbers implied.

The research also showed that the biggest impact to dividend payments came from the mining sector, where payouts were £2.6bn lower than in the same period last year.

This 'mining effect' knocked a tenth off the third quarter's UK-market total. If miners were excluded, underlying growth would have reached 2.6% on a constant-currency basis during the three months to the end of September.

With banking dividends broadly flat and with momentum stalling in the oil sector, there were no major drivers to offset lower mining sector payouts.

Elsewhere, utilities made the largest negative impact, while the most positive contributions came from pharmaceuticals and the industrial sector.

Meanwhile, the strength of the UK economy in the first half of the year saw mid-caps outperform their blue chip counterparts by 3.6%, on an underlying basis, to -4.4%.

Therefore, Computershare has reduced its dividend forecast for the year. It now believes buybacks and exchange rates will knock £3bn off regular dividends this year, leaving UK companies to return £86.8bn to investors. This is a 0.3% decline from the 0.1% growth it forecast in July.

Fiona Smith is head of responsible investment at Smart Pension.

WHY SHARIAH-COMPLIANT INVESTING MATTERS IN THE PENSION MARKETPLACE

Although certainly not a new endeavour, shariah-compliant investing has come to the forefront of industry conversations due to an increased focus on diversity and inclusion in financial services.

Shariah-compliant investing means to invest into funds that adhere to the core governing principles of Islam under shariah law.

Prohibition of Riba and avoidance of Haram are two key components of shariah-compliant investing. Riba refers to paying or receiving interest, both of which are forbidden under Islamic law, while haram is an Arabic word relating to prohibited activities under Islamic law. When it comes to shariah investing, gambling, alcohol, tobacco, adult entertainment and some meat industries, among others, are excluded from investments.

There are also additional considerations relating to uncertainty of outcomes, proportionate risk and transparency which must be applied in order for the investment to be considered shariah-compliant.

One of the aims of auto enrolment has been to increase the provision of retirement saving to those who were previously underserved. There's no disputing the success of auto enrolment in increasing participation and savings into workplace pension schemes in the UK; earlier this year, The Pension Regulator announced that more than 11 million people have been enrolled into a workplace pension since 2012.

Unfortunately, there's a huge number of UK savers who continue to fall through the metaphorical cracks when it comes to pension provision. Among them, many Muslims are excluded from saving for retirement through a workplace pension, due to the lack of suitable investment options.

According to 2021/22 Census data from the Office of National Statistics, National Records of Scotland and the Northern Ireland Statistics and Research Agency, more than 4 million people identified as Muslim in the UK. This makes Islam a significant portion of the UK population.

However, a third of Muslim employees don't have a workplace pension, with a vast majority of these (78%) citing a lack of shariah-compliant investment options as a key barrier[1].

Additionally, the Muslim community in the UK has an average age of 27[2], significantly younger than the average age of the UK's general population which hovers around 40. From a pension perspective, many Muslim savers still have considerable time for their retirement savings to grow – if only they were saving into a pension in the first place.

These numbers indicate a significant gap in the provision of workplace pensions in the UK, and raises the question: can the investment and savings industry, and in particular the workplace pensions sector, do more to cater for the communities we serve?

At Smart Pension, we have been committed to positive change by launching the Halal Workplace Pension earlier this year, the first shariah-compliant lifestyle strategy launched by a master trust. This was built in partnership with Wahed, a provider of shariah-compliant investments, including access to sukuk investments, equities and gold investments. We all know that saving is important, particularly saving into a pension. That's why we're excited to be breaking new ground in the retirement saving marketplace with a pension scheme that features a shariah-compliant lifestyle strategy, available to employers as a default. Existing shariah-compliant pensions options tend to offer single equity funds that members have to actively select, with no risk management approaching retirement age.

It's the first step in what we hope will be many in delivering improved accessibility and greater inclusivity when it comes to savings and investments. These options not only open up pension provision to underserved communities but also provide opportunity, offering investment diversification while seeking growth. We continue to strive to be inclusive and diverse, catering for a range of needs, to shape an industry reflective of society.

For more on Smart Pension, read pages 12-15.

1) https://www.islamicfinanceguru.com/articles/1-3-of-muslims-will-lose-13-billion-over-next-generation-pensions
2) https://www.ons.gov.uk/peoplepopulationandcommunity/culturalidentity/religion/articles/religionbyageandsexenglandandwales/census2021

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THE APPEAL OF PRIVATE MARKETS

Private assets are an increasingly important investment priority for pension schemes across the board. Thanks to either direct intervention, or indirect pressure from the government, investing in private assets and diversifying pension funds is becoming a greater focal point for scheme and member.

Outside of government intentions, however, we see private assets as core to our investment and member engagement strategy. How and where pension funds invest is absolutely relevant to members if communicated well. Building a bridge between the abstract world of investing, and the real tangible world members live in, is a powerful way to engage people in their retirement funds.

Under this government, the Mansion House Compact has become much more specifically about investing pension assets into the UK to aid the country's growth. The government will be looking to schemes who are most prolific at investing in the UK to lead the way on its growth charge. But for us, first and foremost, this is about member outcomes.

Investments of course have a primary purpose – financial return. But it shouldn't be underestimated how the right investments can engage and inspire savers, as well as help their pension pots grow over the long-term.

The most important determinant of how much someone gets out of their pension is how much they put in it. Coming a close second are their investment choices and how much they pay in fees. The right investments can truly engage scheme members, developing a connection between them and their savings. This engagement is part of what encourages them to continually contribute to their all-important nest eggs.

Aligned with the Mansion House Compact, we think tangible investments can be a hugely powerful tool. It's fortuitous this is the way the current government thinks too.

One of our primary examples of this is an investment in Low Carbon Farming, an innovative company that runs sustainable farms in Bury St Edmunds and Norwich. It's 10 times more productive than field farming, using 10 times less water and produces a carbon footprint 75% smaller. It's likely our members have bought and eaten a pepper or tomato that their pension has funded. How great is that?

Their pension funds are truly being put into action by not only producing agricultural produce, but also demonstrating how their money is helping power a sustainable business and generate a financial return at the same time.

We have other similar examples that directly connect our members with the investments that will ultimately deliver their retirement and their future.

Examples like these are immensely more powerful to communicate to members than your typical bond and listed equity investments.

This is real life with tangible results, rather than stock price movements of a manufacturer thousands of miles away. When we can communicate something visceral, something real, it helps people better understand how their money is being put to use.

Whilst NatWest Cushon will always look at potential investments on their merits and at the value for money they deliver members in terms of net returns, we also see value for money in broader terms.

We don't just see investments as investments: they have multiple secondary benefits alongside a great financial return. Whether that's to engage our members, to help preserve the planet in which they will experience their pensions, or to help promote UK growth.

As an industry we need to be innovative with how we inspire and communicate with our members. Private assets are an effective route to tick many of those boxes.

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INTERVIEW – JAMES LAWRENCE

"You cannot compromise on returns."

The head of investment proposition tells *Andrew Holt* about building the master trust's brand, getting tough with companies that don't listen, the importance of diversity and offering a fresh perspective.

You have hit £6bn of assets under management. That is a big number in a relatively short period of time as the master trust was only created in 2014. What is behind this dramatic rise?

There have been a few things. The consolidation piece has been huge. We are one of the biggest consolidators in the market. That has driven a lot of our assets.

Our investment performance has been pretty good, as well, in the past three to five years. We have been top quartile.

Because the base of our business is auto-enrolment and SMEs, and we are now moving to clients with bigger mandates, we have such sticky business. The contributions keep rolling in and compounding. So there are a few different things.

You mentioned that you have been consolidating other master trusts into your organisation. What is the strategy there?

It is mainly to keep growing. We want to be one of the big players in the market, to be one of the final master trusts' standing. So it is reaching that critical mass.

We are able to do that because we have built the technology from scratch in less than 10 years.

Being purpose-built for pensions makes it easy to plug master trusts into our master trust.

Are you taking over any other master trusts?

We are. There is nothing we can announce right now, but we are working on a few deals. We have become the consolidator of choice in the industry.

You mentioned your successful investment performance. What is your investment philosophy?

There are three pillars to our philosophy.

First, we aim for pretty punchy growth. We believe in going punchy on the growth side of things, but tempering it a little.

Second, we believe in active management, but in the right places. This typically means bonds, private markets and the more impactful investments. Around a quarter of our default is actively managed, a high proportion compared to other master trusts.

Finally, sustainability is core to what we do. It is not a tick box. It runs through everything [we do] and is non-negotiable. We don't just have an allocation in something impactful. All investments need to be here in 30 to 40 years' time.

Performance has been pretty good on the back of that. We are 80% equities, with the rest in private markets and active bonds. We are never going to compete with the pure equity strategies out there, particularly over short periods.

Are your equities global or UK?

When I joined over three years ago we were pretty much overweight the UK. That has changed.

We are now broadly market-weight UK. Based on that, we don't see the structural reasons to be overweight. That might change, but we are now pretty much global.

Are any of your three pillars more important than the others?

They are all pretty important. The tempered growth is probably the biggest thing that is going to make a difference to our members and our outcomes.

And flowing through all that is the commitment to ESG.

We have a team of responsible investment people and we are seeing the merging of what they do with the core investment side of things. It is no longer a separate team.

You set a 2040 net-zero target. Does that come on the back of that philosophy?

You cannot compromise on returns. Our 2040 net-zero target is one of the earliest in the market. The reason is we are seeing data which shows that 2050 is too late to meet the 1.5-degree commitment.

We want to go quite big and punchy on this. Everything we are doing is aimed at that. We have just built a bespoke index for our passive equities, which has a net zero by 2040 target. Everything we are doing has that lens.

We have just received our latest carbon footprint [data] and have achieved a two-thirds reduction since 2019. So we are well on our way to hitting carbon neutrality in 16 years.

How do you deal with companies not up to scratch on ESG? Does it mean more engagement or perhaps divestment?

We have evolved. Originally, we were hard on the stewardship and engagement side of things. We worked with the industry on a lot of those areas but found it just didn't resonate, particularly with a few big players. Some of the big financial companies, the big oil and gas companies and the energy companies haven't done enough in this space.

So we have started taking steps towards divesting. We are not going to pretend that our £6bn master trust is going to move the dial, but it might start conversations and get some attention.

Also, we don't want to be invested in companies who are not listening. So we have moved to a stricter stance on those companies.

You signed the Mansion House Compact. There is a lot of debate about it, so why did you sign up?

Firstly, being a British fintech [the trust parent company], which has benefitted from venture capital and private equity investment, it is something we want to continue to support using our own pension money.

We want to grow businesses, particularly in the UK, like we have over the past 10 years. We already have private credit, we are close to doing private infrastructure and are working on that private equity theses, which is in line with Mansion House.

It is the right thing to do. If you follow the Australian and Canadian models, private markets have supplied some strong returns over the 10 to 15 years since the financial crisis.

> **We don't want to be invested in companies who are not listening.**

Can you understand some of the scepticism within the pension fund industry towards what the Compact is trying to do?

I do. The fact that it wasn't UK only, even though it was supposed to be UK, helped to get more [investors] on board.

I see some scepticism on private markets in general, particularly over the past two to three years. Some private markets, like private equity, have not delivered what they probably should have done. So it has been a bit tricky, but long term it is the right thing for us.

The government has made numerous statements about the role of pensions. What have you liked and disliked?

It seems that they have started to listen to the industry, although this began with the Conservatives. The collaboration between the Financial Conduct Authority and The Pensions Regulator on Value for Money (VFM) is the right thing to do. We have been pushing for transparency around costs for some time and these are the things they are looking at.

For VFM, Mansion House is definitely a positive. Great British Energy and the National Wealth Fund will have good indirect benefits for UK pension schemes.

Obviously, mandation, which hasn't been officially announced, is not helpful and is not going to work.

Master trusts carry a lot of weight when looking at the future of the UK pensions industry. Do you feel that pressure?

I'm relaxed. It is a real opportunity to put money to work. There is some pressure as we need to break down some barriers and issues in the market to fulfil our potential as asset owners. I'm not sure we are going quick enough.

What was the driving force behind you joining the Diversity Project?
Diversity has always been important for us as a newish fintech with a lot of young people. We joined the Diversity Project to cement that. But we also joined to learn from others from within the industry: to see what the best thinking is out there, the best practice on how we hire, invest, work with managers and to be part of the conversation across the industry.

I wrote a piece on diversity exploring if it had fallen off the agenda. There were two responses. The first was that it had become politicised, while the other was that organisations are focusing on it so don't need to talk about it. Which view do you share?
It is slightly more of the latter. People and organisations are getting on with it.
Also when it becomes politicised, it brings the worst out in the discussion and you don't get to the source of the issue.
The fact that it has become business as usual has taken it off the agenda, which has helped because you don't get that vitriolic discussion.

It seems the more political stuff like programmes on white privilege, gender identity and decolonisation are not contributing to better investments. What is your view?
Agreed. It definitely takes the focus off what we should be doing. We all need to be working together on this.
At the same time, it can be good to have these discussions, as it can be when we learn the most, when the discussions are on the edge. That is, as long as they are peaceful and respectful.

You have launched a Halal pension. Why was that developed?
We effectively recognised the gap in the industry to provide a sharia-compliant fund. It is making sure we support all communities across the UK as we have 1.5 million members.

So are you looking at introducing similar funds?
Yes. We have launched our Lifestyle strategy and a number of sub-funds, all of which help members to build their own portfolios. This has gone down well.

What have been the biggest challenges during your three-and-a-half years in this role?
Sometimes in this industry you feel as if you are pushing treacle up a hill. The development of investments can be a bit slow.
We are breaking down barriers slowly in this market, but things like performance fees, especially on private equity, is still an area of discomfort.

What has been the biggest change you have made to the assets?
The biggest change is we didn't have any impact investments when I first joined, so that has been the biggest shift. We built an impact strategy, which added 13% of active impact strategies within our default: that is in biodiversity and green bonds, in particular.
We also launched our 2040 net-zero goal and effectively switched all of our equity investments into a custom index. So we built a custom index which is 2040 net-zero aligned for between £3bn and £4bn worth of investments.

You joined from Mercer. Why did you make that move?
I was at Mercer for nine years. It was a fantastic place to work. You learn a lot at a big firm like Mercer, but I was looking for a different challenge. Moving from a large consulting firm to a small fintech was something I could get stuck into. I was able to take hold of the investment proposition at Smart and lead with a blank sheet of paper.

JAMES LAWRENCE'S CV

March 2024 – present
Director of investment proposition
Smart Pension

July 2021 – March 2024
Head of investment proposition
Smart Pension

July 2017 – July 2021
Lead investment strategist (Mercer Workplace Savings, and Mercer Master Trust)
Mercer

January 2014 – July 2017
Investment consultant (Defined contribution pension schemes)
Mercer

September 2012 – January 2014
Graduate analyst
Mercer

Was it a nervy experience making that move?
When I was Mercer I was running the investment strategy in master trusts, so a similar type of role. But I saw the role as a great growth opportunity.

What do you see as the biggest challenge at Smart Pension?
To continue establishing the brand. We have been seen as the disruptor and built on the back of that. We are competing and come up against some big names in the market. So it is a case of continuing to prove that we deserve to be in the conversation.

What has been the biggest lesson you have learnt in your career?
I started in the industry about 12 years ago and it is realising, at least in the early years, the importance of bringing a fresh perspective. Therefore you always have something to say, no matter who the audience is, and you should not stay quiet.

DEFINED CONTRIBUTION: THE CHALLENGES AHEAD

There are many issues that money purchase schemes have to navigate. *Andrew Holt* takes a look at some of them.

No longer lauded as the new kids on the block, questions now abound about where defined contribution (DC) pension schemes are heading. Many of these questions are based on the foundations of these retirement schemes.

One of the biggest themes that needs deconstructing is cost and value. "This has been a cost-driven market, which in investment terms has driven DC schemes down a particular road known as low-cost index globally allocated portfolios," says Imran Razvi, senior policy adviser for pensions and institutional markets at the Investment Association (AI).

It does mean most DC pensions are cost-effective, partly because the default investment strategy has usually been driven by these cost considerations but has resulted in largely passive solutions. This therefore needs to change.

"I welcome the notion that we need to take an investment-led approach to default pension strategies, especially when in decumulation, and that the focus should be on value for money – not simply the level of charges," says Euan Munro, chief executive of Newton Investment Management.

But other factors have to come into play as well. "Our view is that DC pension schemes are developing significantly and quickly with regards to investment sophistication through scale, innovation and sponsor interest – this is only going to continue with the focus and drive from the UK government and regulators," says Stephen Budge, a DC investment consulting partner at consultancy LCP.

Government push

So there has been a big push from government and regulators to get DC schemes focused on two areas. The first is a move towards UK investment. "That is challenging, depending how you go about achieving that," Razvi says.

"There is a feeling that pension schemes will not get there if left to their own devices when you look at their current investment behavior," he adds.

The impetus therefore for Razvi is for the government to make UK investments more attractive to DC schemes. "That is things like tax incentives which can be applied to pension schemes to get them to invest in particular areas."

And second, is the focus on getting more DC schemes involved in private markets. "It is this area, where we at the IA have been heavily focused over the last couple of years from the standpoint of trying to make sure DC schemes have access to those asset classes. Should that be a road they choose to go down," Razvi says.

Private markets allocations within DC are, it seems, going up. Legal & General research shows that for DC schemes seeking to grow their private market allocations, a key challenge is cost and transparency: 57% see high management fees/costs and limited reporting as more of a challenge to DC pensions than liquidity (43%).

"Private markets are a definite trend with our clients," Budge says. "They appointed well over £1bn of DC friendly private-market funds during 2023.

"However, there remains a lack of choice available to schemes which we believe must be seen as a market failure," he adds. "Even with all of the interest and focus in this area, certain corners of the provider market still do not offer choices for scheme and member investment."

For Razvi, it is a slow process. "Some schemes are [involved in private markets] and some are talking about it," he says. "But it is a slow-moving market."

Government pressure

The key question that hasn't been answered yet is whether the government will ultimately deploy a stick to direct investment to help drive the UK economy. It would be an unpopular move. "While this is unlikely, we expect the pressure will remain for the foreseeable future," Budge says.

But this aside, Razvi still believes there is a private markets investment case for DC schemes to embrace. "Given the amount of activity within private markets and the shrinking size of the listed world, it makes good sense to consider when private markets should play a role in a portfolio," he says.

However, there are reasons for the current positioning of DC schemes. "Historically, it has been quite difficult for DC schemes, largely due to the fund structures to help them achieve that [wider investment]. The whole daily dealing architecture that DC schemes work around has also proved quite challenging," Razvi adds.

Moreover, the investment approach has been a simple tried and tested playbook. "In our view, the question of portfolio construction early in the DC lifecycle is a fairly simple one to answer – take as much risk as you can, typically, in equities, and then ride the wave for the next 30 years," says Chris Parker, head of institutional clients in the UK and Ireland at Man Group. "If you have a big drawdown, it's generally fine – you are staying in the market for decades to come," he adds.

However, as people get closer to retirement, this high-risk tolerance naturally changes significantly. "A large drawdown closer to retirement can be extremely difficult to recover from, and an increasing number of DC members are reaching that point," Parker says.

Classic portfolio

Indeed, many DC strategies are built on the classic 'diversified' portfolio, that is, a balance of equities and bonds. For years, its proponents have argued that when one asset class in the mix is affected by poor performance, the other one will pick up the slack.

However, research by Man Group shows that when core inflation is persistently above 2.7% per annum, the correlation between equities and bonds – that is, the similarity of positive and negative performance – has historically been positive on average. "That means, in a shaky equity market during these periods, investors can't necessarily rely on bonds to provide portfolio stability.

"Just look at 2022. Equity and fixed-income assets suffered significant losses at the same time," Parker says.

This assumption that bonds and equities will always diversify one another is changing, and many pension schemes and asset allocators are turning to 'alternative' approaches to either enhance returns or provide a diversified-return stream. "This term captures a wide variety of asset classes, but the focus has largely been on private assets via structures such as long-term asset funds," Parker says.

This means there is much for DC pensions to ponder – but ponder they must. "While it's clear that these assets have a role to play, investors should consider broadening their definition of what constitutes alternatives to include 'liquid alternatives' too, namely assets that can provide the diversification they need when they need it," Parker adds. "DC investors shouldn't just be adding new asset classes, they should also focus on adding different return streams."

The diversification illusion

Diversification and uncorrelated return streams are important, but they also need to work when investors need them most. "With private equity and venture capital, for example, the promise of diversification can be illusory," Parker says.

"A valuation lag – the delay in asset pricing, as there is no exchange to offer daily liquidity – creates the illusion of lower volatility, but returns may be highly correlated with the main risk factor in a DC portfolio: public market equities," he adds.

A more liquid expression of a diversifying multi-asset portfolio may then offer more robust portfolio construction benefits than simply relying on expanding the asset mix.

"Using a flexible, market-neutral approach to major liquid asset classes, meaning that the strategy can short sell as well as positively own an asset class, for example, allows investors to target multiple sources of potential returns and increases the chance of accessing a truly uncorrelated source of return," Parker says.

"And by using liquid underlying instruments – equities and bonds, rather than more difficult-to-come-by and difficult-to-trade real estate and infrastructure assets – helps to make the portfolio more cost-effective, more transparent, and importantly more liquid," he adds. "DC investors should be targeting diversification by design, not simply by chance."

Cautionary consolidation

There are other factors to consider, which are set to shape the DC pension landscape in the coming years, says Jayesh Patel, head of DC clients at Legal & General. "Firstly, regulatory changes will continue to influence DC pension plans, particularly around consolidation and the evolution of investment strategies, following the pensions investment review consultation," he says.

And, of course, this shadow of scale hangs heavy over the DC world. "That has clearly been the direction of travel for some years now," Razvi says. "We have coined a phrase 'sophisticated scale', which is to say if you are going to make these schemes bigger. Then a bunch of things need to happen alongside that."

This, Razvi adds, is largely around enhancing governance and expertise of the investment world and the ability to make allocations across a broader range of asset classes and on a global diversified basis. "That is a set of structures that has to be put in place. It doesn't automatically come from making everything bigger," he says.

Though as with much of the DC market, things though are likely to take time. "We expect the future will look like a much more consolidated DC market. However, it will and should take time to work through," Budge says. "We need to be mindful that the overall drive for consolidation doesn't undermine the good progress being made by single employer trusts – we must consolidate with caution." One of the reasons Budge holds this view is because we are already in a consolidated market from a pension provider point of view. According to LCP's calculations, more than £620bn of DC assets are managed by a handful of providers – across their product ranges – highlighting a much greater level of consolidation than seen in markets such as Australia. It also indicates the scale we already have in the UK's DC market at the provider level.

> **As retirement patterns change in the future, so too should investment approaches evolve.**
>
> Jayesh Patel, Legal & General

"While the overall trend is to master trusts, we are seeing interest with trustees and employers about running-on their DB schemes as an alternative to buy-out, which creates potential support for DC funding in the short to medium term with hybrid arrangements," Budge says.

The second theme identified by Patel is as life expectancy continues to increase, there will be a greater need for DC plans to provide sustainable income over a longer retirement period and effectively deliver a 'paycheck' in retirement. This, in part, can possibly be addressed by better and wider investment decisions.

Third, is the role of technology in shaping the evolution of the DC landscape. Advancements in AI and machine learning can help personalise pensions further to better engage members and drive action.

"As retirement patterns change in the future, so too should investment approaches evolve," Patel says. "DC schemes should look at investment – particularly decumulation investment solutions – as a key component to improving outcomes for DC savers. We see market consolidation and the evolution of investment strategies as a key driver in helping to grow retirement savings."

Indeed, one of the major challenges Patel sees – and one likely to continue being a challenge for a while – is around adequacy. "Meeting the adequacy challenge and helping savers meet their retirement objectives should be one of the main priorities for the industry," he says.

Addressing and eliminating pensions gaps is another significant challenge DC schemes face. Notable groups that face a larger pensions gap are women, those with illnesses and minorities.

A point of focus of innovation is post-retirement, which is now referred to as 'guided retirement'. "We expect to see significant improvement in this area over the coming years with the focus of government and regulators as well as the innovation we are seeing in the market," Budge says. "This is a critical step for members in delivering better outcomes through income. Yet, it has been an area where focus and attention has been lacking. We are pleased to see this is a priority area for the regulator."

End of cheap money

Then there have been wider economic changes. Over the past two years, we have witnessed shifts in important economic and investment conditions, as several multi-year or even multi-decade changes came to an end.

The end of so called 'cheap money' has led to higher and less stable correlations between asset classes, which makes diversification of investment portfolios more challenging.

"These dynamics pose new challenges for DC schemes to deliver superior investment returns," Newton's Euan Munro says. "The correlation between equities and bonds has shifted from risk-mitigating to risk-additive for DC schemes, meaning that more needs to be done to equip portfolios for the market context we face, and ultimately to meet individuals' retirement expectations."

This means being more dynamic and embracing new sources of return, which have traditionally been overlooked in the world of DC asset allocation. "Liquid alternatives have the potential to meet this challenge," Munro says. "Equity income has also been overlooked as an approach. Ultimately, this is something DC schemes will have to prove capable of doing far more than has traditionally been the case."

Broken DC

Although offering another and far more provocative piece of analysis, consultancy WTW says DC pensions are broken. Senior director Edd Collins says: "There is an issue that has been brewing and hidden from view and it needs greater attention than we see today.

"The fundamental challenges are around the retirement piece: how do you help people through retirement?"

Instead WTW offers four alternatives to the DC market. The first is based on whole-of-life collective defined contribution (CDC). "This is effectively the solution the Royal Mail has launched. For me this is the purest design that allows you to share risk for the longest period of time and gives the best outcomes, because you have the greatest freedom and the longest period of time to invest," Collins says. "Although there is the challenge of the variability of the pension to go down."

The second is what he describes as defined benefit with variable increases. "This is a bit of a build on CDC, providing a guarantee that pensions will never be cut. But employers are on the hook for increased costs. The downside is the existence of that guarantee means DB funding leads to taking not as much risk. So if you are not taking as much risk then you are not going to get as much return," he says.

The third is DC pots used to buy CDC retirement incomes. "This takes the line of in the post-retirement phase buying CDC. It gives the employer the chance to say that they do DC and that is their bit, and you go and buy the CDC at retirement. This gives a separation between any decisions to cut pensions down the line," Collins says. "Although it doesn't do as good a job as whole of life CDC, as you have a shorter timescale."

The fourth option is a variable cash balance with CDC in decumulation. "This tries to provide a more stable version of DC," Collins says.

Scanning across these, he says: "The majority of employers prefer the third option. But we need regulations from government to allow that, and other innovations, to happen."

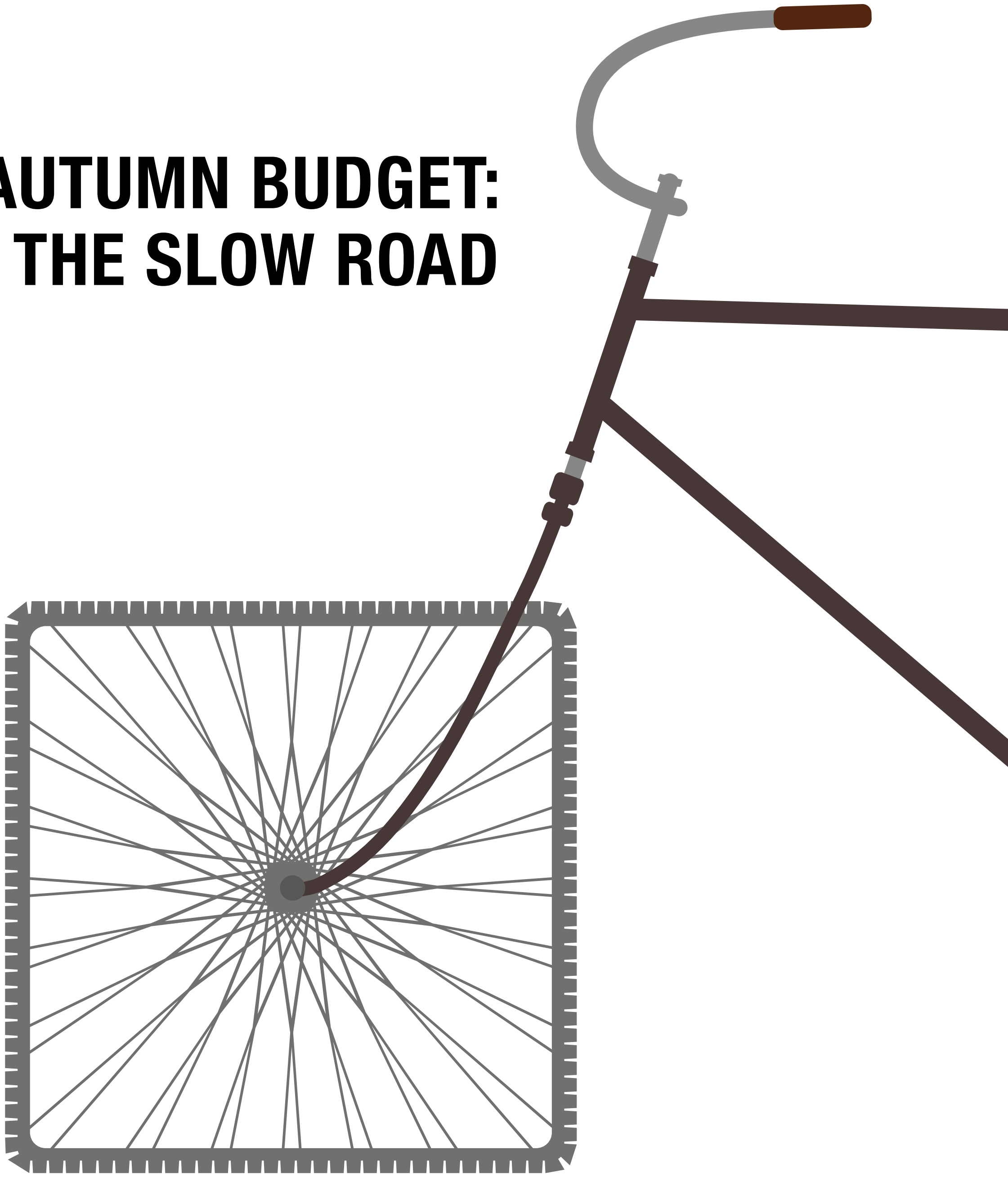
But it is interesting to note that a great deal of the necessary changes to DC comes down to simply greater knowledge. "DC schemes and their investment managers need to do more to educate members about the role of diversifying strategies, like liquid alternatives, and why it is beneficial to invest in them as end users," Munro says.

"Risk needs to be better understood, including as to why sticking with the status quo may represent a significant risk in itself."

DC investors shouldn't just be adding new asset classes, they should also focus on adding different return streams.

Chris Parker, Man Group


PORTFOLIO INSTITUTIONAL
AWARDS
2025
15 May 2025



THE AUTUMN BUDGET: TAKE THE SLOW ROAD

Time, at least in the institutional investment world, seemed to stand still in the lead up to the UK's Autumn Budget. Investors became non-committal when asked about investment options as well as the wider outlook, offering one refrain: "Let's see what happens in the Budget."

Now that the chancellor, Rachel Reeves, has offered up what was the most anticipated Budget in living memory, it raises the important question of where it leaves investors. Rain Newton-Smith, chief executive of the Confederation of British Industry, said Reeves is taking a "slow road to growth".

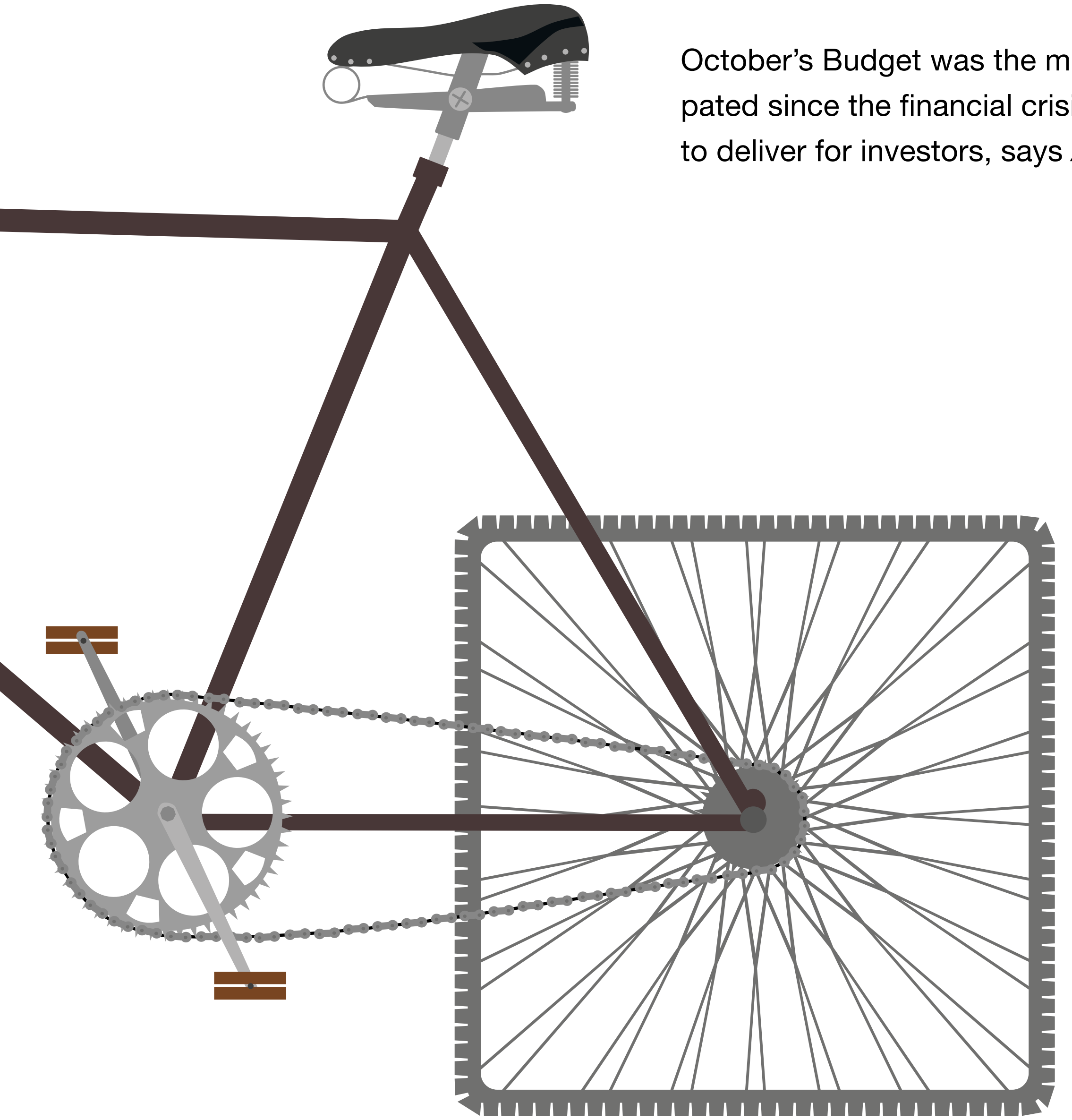
Investors could well draw the same conclusion about investment – there was a lot of talk about it. In fact, Reeves said the "only way to drive economic growth is to invest, invest, invest". But the road to investment that emerged from the Budget appeared long, winding and with no real roadmap, even if there are pinpoints along the way.

This is despite investment themes, or at least the rhetoric, being strong in the Budget. "To rebuild our country, we need to increase investment. The UK lags behind every other G7 country when it comes to business investments as a share of our economy. That matters," Reeves said.

She added that there will be £70bn of investment through the new National Wealth Fund, with reforms to "planning laws to get Britain building again". The National Wealth Fund announced by Labour early this year was established to boost economic growth and accelerate the transition toward clean energy.

Catalyse investment

Earlier this month, Reeves said the fund would work with investors to deploy up to £27.8bn of investment, with £22bn coming from the UK Infrastructure Bank and the British Busi-



October's Budget was the most anticipated since the financial crisis but failed to deliver for investors, says *Andrew Holt.*

ness Bank establishing a British Growth Partnership to encourage more pension fund investment into the UK's fastest growing and most innovative companies.

"The UK has fallen behind in the race for new jobs, new industries and new technology," Reeves added. "By restoring economic stability and by establishing the national wealth fund to catalyse private funding, we have begun to create the conditions that businesses need to invest," she added.

Reeves also revealed that Labour's new rules on borrowing to invest will allow more than £20bn to be pumped into the "growth industries of the future".

"This includes at least £6.1bn to protect core research funding for areas like engineering, biotechnology and medical science through Research England, other research councils and the National Academies [of Science, Engineering and Medicine]," Reeves said.

The chancellor also allocated funding to specific areas of research and development, including £2bn for automotive technology, £975m for aerospace and £520m for a new Life Sciences Innovative Manufacturing Fund.

The UK's contribution to the EU science programmes, agreed by the previous government in 2023, will be funded at a cost of £2.7bn a year.

The government will also extend the Innovation Accelerators programme in Glasgow, Manchester and the West Midlands.

Clarity and certainty

"We share the chancellor's vision to grow the UK economy and 'invest, invest, invest', said Chris Cummings, chief executive of the Investment Association. "Long-term investment is truly the engine of growth, and our industry already channels £1.4trn into the UK economy.

"Long-term investment also needs clarity of approach and policy certainty," he added. "The proposed modern industrial strategy and corporate tax roadmap are a welcome starting point to attract greater capital."

The lack of clarity on the nature of the investments is a big sticking point. "We look forward to working with the government, alongside the National Wealth Fund, to channel investment into innovation and growth-driving sectors," Cummings added. "But this is the beginning of the journey and more will be needed to build domestic and international confidence to drive strong UK capital markets and reinvigorate economic growth in partnership."

He also said that the chancellor had missed trick. "Fostering a culture of inclusive investment is also important to improve people's financial resilience, yet the Budget was a missed opportunity to implement measures which could see more people reap the benefits of investing."

Summing up the frustration with the Budget, Iain Campbell, head of LGPS investments at consultancy Hymans Roberston, said the Budget was a let-down for the local government pension scheme (LGPS). "The Budget was somewhat of a damp squib for the LGPS, with no further updates to their plans for issues like encouraging UK investment," he said.

Nigel Peaple, chief policy counsel at the PLSA, was a little more conciliatory. "We welcome the focus in this Budget on investment, in particular, the change to the fiscal rules to support public investment and the promise of policy certainty provided by a long-term modern industrial strategy," he said. "We also welcome the government's use of the British Business Bank and the National Wealth Fund to facilitate pension fund investment in the UK, as we've recommended."

Andy Briggs, chief executive of Phoenix Group, added that he hopes the government can still boost investment. "The way government invests alongside the private sector will be critical boosting growth in the UK," he said. "Changes to the fiscal rules make economic sense if implemented in the right way.

"As a committed domestic investor, we hope these changes will ensure our capital works better alongside the government and helps catalyse investments in the social and economic infrastructure the country needs," Briggs added.

Stronger emphasis

David Brooks, head of policy at consultancy Broadstone, said that despite the lack of detail in the Budget there is still much for the pensions and investment industry to look out for further down the road.

"We anticipate the chancellor will place a stronger emphasis on pensions in the upcoming Mansion House speech in November," he said. "The summary of the first part of the pension review is imminent, and the second part of the review which is due to look at adequacy and wider issues, will also be launched around this period.

> **What matters to bond markets is a good story about growth.**
>
> Andy Haldane, economist

"The Pension Schemes Bill, likely to be before the House [of Commons] in the Spring/Summer 2025, also gives us plenty to look forward to, to discuss and plan for, from a pensions perspective," Brooks added.

And John Donohoe, chief executive of fund management company Carne, offered an almost contrarian upbeat take on some of the announcements made by the chancellor, especially in regard to the National Wealth Fund. "This intent to mobilise capital and get it into the economy is a boon for the UK and for private asset management – and we expect to see this play out quickly and at scale," he said.

One detailed announcement involved an increase in carried interest to 32% from 28%. James Klein, corporate partner at law firm Spencer West, highlighted that there would be an impact on fund managers and those working in the investment management industry "to bear the higher tax liability on their carried interest payments as well as the fact that the higher rate might deter new investments and delay new ones which would negatively impact investment into scaling UK businesses".

This may not be the end of the matter according to Greg Pogonowski, wealth planner at financial advisers Kingswood. "It is likely to rise further from April 2026 when it will be subject to a new regime. This could affect returns on funds," he said.

From an ESG perspective, Bramwell Blower, Share Action UK's public affairs manager, said the Budget was "encouraging to see the chancellor taking steps today to increase public and private funding for the UK's clean energy and green infrastructure.

"The government should now introduce ambitious measures to ensure that private capital is invested responsibly, in the public's best long-term interests," he added. "This includes maintaining a robust stewardship code, setting requirements for transparent financial reporting, and reforming fiduciary duty so that our pensions work better for people and planet."

Tax raising

Reeves also wasn't the first chancellor to promise an "end to short termism". Many before her have issued such a message only to be lost in the reality of politics.

The headline surrounding the Budget was that it was the second biggest tax-raising Budget in history, after Norman Lamont walked up to the dispatch box in 1993, despite promises in the Labour manifesto that there would be no new tax increases to the £8bn it had "costed" in the run up to the election.

This for Darius McDermott, managing director of broker Chelsea Financial Services, conflicted with the growth aims of the chancellor. "For a government aiming to spur growth, several of Reeves' policies seem anti-business," he said.

He cited particularly the increased national insurance (NI) contributions and a lowered employer NI threshold which "will drive up hiring costs and increase unemployment".

Within the wider economic context, Reeves revealed her plans would lead to a slightly higher forecast for inflation, with the Office for Budget Responsibility (OBR) saying CPI inflation will average 2.5% this year, 2.6% in 2025 and 2.3% in 2026. It will fall to 2.1% in 2027 and 2028 before rising to 2% a year later.

And when it comes to the economy, the OBR forecasts GDP growth will be: 1.1% this year and 2% in 2025. It falls to 1.8% in 2026, 1.5% in 2027 and 2028 but making a comeback to 1.6% in 2029.

Reeves says the current Budget will be in deficit by £26.2bn in 2025-26 and £5.2bn in 2026-27, before moving into surplus of £10.9bn in 2027-28, £9.3bn in 2028-29 and £9.9bn in 2029-30.

> **For a government aiming to spur growth, several of Reeves' policies seem anti-business.**
>
> Darius McDermott, Chelsea Financial Services

Bond impact

With the 2022 Budget fresh in investors' minds, many looked at how all this impacted on bonds. Since the Budget, bond yields spiked leaving the 10-year gilt yield to sit at around 4.36%.

Hal Cook, senior investment analyst at Hargreaves Lansdown, said: "The uncertainty surrounding this specific Budget had made bond investors nervous, with expectations of higher future borrowing in particular weighing on sentiment towards the attractiveness of UK government debt."

The combination of these factors meant that the yield on 10-year gilts had risen to around 4.3%. "This remains lower than the level that they hit following the commonly referred to 'disastrous' Truss/Kwarteng mini-Budget in September 2022," Cook added.

In what was a huge move, the 10-year gilt yield moved from around 3.3% a couple of days before that mini-Budget, up to around 4.5% days after it.

Yields up

Investors do seem to have pulled back on the number of interest-rate cuts that are now likely, as shown in the swap markets as a result of the budget, pushing up the yield on rate-sensitive two-year bonds.

But Andy Haldane, the former chief economist at the Bank of England, said the bond market is unlikely to hit crisis proportions. "My guess would be that bond markets won't fall out of bed. And, of course, what matters to bond markets is a good story about growth," he said.

But the key point is the Budget failed to put investors centre stage in the way many expected given the chancellor's commitment to growth. Something Reeves needs to rectify.

"Only the private sector can provide the scale of investment required to deliver the government's growth agenda," Rain Newton-Smith said. "It's vital that the government doubles down on its partnership with business to unlock the investment that is needed to drive opportunity around the UK."

There were other concerned investment voices with different takes on what Reeves announced. In an investment note, asset manager Investec said the Budget "is a calculated risk which could backfire, leaving the UK's fiscal position in a worse mess than when it started".

Whether that could be the outcome of the 2024 Autumn Budget only time will tell. In the meantime, investors will have to wait longer to see what the government has up its sleeve to create the hoped for investment boom. The clock though continues to tick.

DISCUSSION: DC AND PRIVATE MARKETS

Defined contribution is believed to be the future of the British pensions industry and their allocations to private market assets are growing. This trend warrants a timely discussion with a group of industry experts.

There was a time when defined contribution (DC) pension scheme portfolios were packed full of listed equities and bonds. Many still are, but their exposure to private market assets is growing.

Buying a stake in a young but growing private company, an industrial warehouse serving the digital economy, lending money directly to the borrower or building a wind farm to help transition the economy away from oil and gas can bring much to a portfolio.

Such assets offer diversity, protect against inflation and perhaps provide higher returns than their listed-market peers. But it's not all good news as they also reduce the liquidity of a portfolio.

So with a fine balance between risk and reward, how are trustees approaching alternative investments.

It starts with what members need, Aon's Joanna Sharples said. "There will be lots of challenges along the way, but fundamentally it has to be in a member's best interests, from a risk and return point of view, to invest in those assets," she added. "Fiduciary duty is at the heart of it."

USS has owned private market assets for almost 20 years, initially for its defined benefit members. But in 2020 it decided to include its DC section in the allocation. Over the course of the year its illiquid holdings went from zero to 20%, or around £600m.

The DC retirement scheme for academics is now exposed to infrastructure, private equity, private debt and property. This year it added private equity co-investments to the portfolio.

"We had to take our board and investment committee along the journey, which was challenging because at the time nobody else was doing this in the UK," Naomi Clark said. "The pandemic hit as we were doing that. It was a good test of our enhanced valuation process, and it worked well."

USS intends to increase its illiquid assets by the end of this year. "We believe in [private markets]," she said. "The risk-adjusted returns are fantastic, and it's a great diversifier within the portfolio."

Also looking to increase its exposure to alternatives is NatWest Cushon, with Veronica Humble explaining that a range of asset classes are being considered within its 15% target allocation to illiquid assets.

The regulator must be happy that DC trustees are so bullish on these markets. Indeed, Pavan Bhardwaj, who chairs the investment committee of a £3.54bn DC scheme and sits on another for a master trust, said money purchase schemes have to include an illiquids policy within their statement of investment principles. "It is forcing trustee boards to at least give it some thought and have a view on whether they are ready to take that step or consider it at a later stage."

The own trust scheme he sits on has the scale to do it in a "meaningful way", but there is no indication of when that will happen. The only certainty is that it is being considered by the trustees.

The master trust also has the scale to tackle this given that it manages £10bn of assets, and he would not be surprised if a meaningful allocation to illiquids was introduced within the

growth strategy. "Within the next year to 18 months, potentially all of the top 15 master trusts will offer a strategy which has some allocation to illiquids," Bhardwaj said.

The first step

BNP Paribas Asset Management, which manages a diversified private credit portfolio for Nest, focuses on credit, and for good reason.

If a typical default is around 10 basis points, a 10% allocation to private equity would force your default fund fees up, making it difficult to win new business, said BNP Paribas AM's Philip Dawes.

"A lot of people are dipping their toe in the water with credit, and over time will meet their Mansion House Compact allocations through switching to private equity."

Dawes added that the Mansion House Compact missed a trick given that private equity is the only way for many DC schemes to invest in emerging green technologies, but the volume is low. "We understand the direction of travel, but to get meaningful amounts of money into private markets, it's mainly through credit that it is going to happen," Dawes said.

For Jo Waldron at M&G Investments, while other alternative asset classes might offer higher returns, there are other benefits to investing in private credit. "Their floating rate nature is a great diversifier against public assets, which was proven in 2022 when they were nowhere near the negative double-digit returns we saw elsewhere."

On trend

Private credit is a trend Sharples is also seeing in DC. "For a lot of our clients, private assets are a whole new world, and they don't know much about it."

She added that investing in illiquids should not be like "chucking a child in the deep end" for their first swimming lesson. "Providers are on a journey, so starting with lower risk, contractual assets, like private credit, makes sense to get their members comfortable," Sharples said.

As people become more confident the risk and return profile will increase. "It is a journey and we will see bigger allocations and more interesting assets as we go through," she added. "But this will not happen overnight."

But how are DC schemes allocating to private credit going to fulfil the goal of the Mansion House Compact, which appears to encourage private equity investments in UK assets?

For Waldron, the trend for private credit is positive as companies need debt to scale. "It is not that private credit isn't helping from a productive finance perspective, on the contrary it is critical, but it is not part of the starting point because the equity piece is more easily thought about."

To back early stage businesses that need capital, there are alternatives to debt, but venture capital lacks the scale needed for DC schemes to make meaningful allocations.

"Is supply of capital the issue?" Bhardwaj asked. "Is that going to unlock a whole load of productive investment?

"If it isn't, big institutional investors with capital to deploy are

THE PANEL

Pavan Bhardwaj
Trustee director & head of investment
Independent Governance Group

Naomi Clark
Head of investment product management
USS Investment Management

Philip Dawes
Head of distribution (UK & Ireland)
BNP Paribas Asset Management

Veronica Humble
Chief investment officer
NatWest Cushon

Joanna Sharples
Chief investment officer
Aon DC Solutions

Jo Waldron
Head of private markets solutions
M&G Investments

not going to move the needle. But if the supply of capital is a factor, then we could see more of a venture capital industry within the UK taking effect.

"So maybe venture capital as an asset class will grow once there is almost guaranteed capital on tap awaiting deployment," Bhardwaj said.

A lack of scale could deter some from the market. USS puts a huge amount of work into every investment it makes, which, when considering the average ticket size of a venture capital investment, could be an issue.

"It is the same amount of due diligence whether we are investing £1bn or £100m. But if it is £20m, it becomes resource intensive and is a barrier to doing that on a wider scale," Clark said.

On the issue of available capital, Dawes said a decade after a company he worked for launched the UK's first infrastructure debt fund, there is a dearth of such investments in the UK. "PFI/PPP has become a dirty word," he said. "The government doesn't want to use that as a mechanism and therefore projects are not coming through," he added.

> **Maybe venture capital as an asset class will grow once there is almost guaranteed capital on tap awaiting deployment.**
>
> Pavan Bhardwaj, Independent Governance Group

"If you want to get money into the real economy, whether it's DC or other forms of institutional capital, the government needs to make more investments available for people to buy. That is an issue."

So could asset managers help their clients access certain assets. It appears they are starting to understand the needs of asset owners.

Humble has seen a change here in the past few years. "There is now a contingent of asset managers who understand DC."

A few years ago, every conversation she had started with: "We don't need steady cashflows in the growth phase of DC. We need steady cashflows on the way in. Are you able to allocate this?" she said

"Now there is more understanding that there is value in those steady cashflows. So we are seeing some movement in price as well. But again, it is a little slow.

"If you look back five years, we have come a long way, but it is still at a fairly slow, steady pace," Humble added. "So it will be interesting to see what the government does, because they clearly don't have the patience to wait at the same level."

What's the cost?

Dawes is seeing a debate emerging around whether a fund of funds or a specialist multi-manager is the right structure to start building an illiquid portfolio. The other option is a diversified private markets manager who focuses on credit.

"If you have the scale like a USS or a large master trust, you could probably go down the specialist route," he said.

"But one of the challenges for people that perhaps don't have that scale, which is the lion's share of the market, is that if you allocate across a number of specialist managers, you haven't the purchasing power to get those fees down."

The multi manager and fund of funds approaches have a direct impact on fees. "That is why some segments of the market haven't moved into private markets. They are in paralysis. They don't quite know how to deal with this issue."

There are other issues around that model. "In order to ramp up and deploy capital quickly, you could make commitments to five managers, but you lose the ability to actively asset allocate across the underlying asset classes," he added. "That can add meaningful returns for clients, as we have discovered over the last five years.

"So you can turn sleeves on and off, which you can't if you make those static multi manager and specialist fund of fund allocations.

"Fees are an element of this. People can't design the structure that they want with their buy-rated list of managers, because they can't afford it," Dawes said.

"Half the market has moved. The half that hasn't, is stuck."

The price is right

Sharples drew a distinction between own trust schemes and master trusts. She said decision making is easier in the own trust environment because it is just you and your members. But master trusts are working to gain market share, so there's a lot of consolidation going on.

"The challenge for master trusts is that a lot of their clients are buying on price," she said. "It is not unusual to get ruled out because you are the most expensive, and the bottom set go through to pitch."

The return might be 1% or 2% higher than the rest of the market, but people still pick up on the one or two extra basis points of fees. "That's the challenge. That needs the whole market to change. That is why people are going for second or third defaults," Sharples said.

Clark added that she gets frustrated when she sees what managers are charging for some products aimed at DC schemes. "I know the cost of doing this directly," she said. "My finance team tell me and it's not what they are charging. It needs to move on both sides."

Can a middle ground be found? "There has to be," Clark said. "We need to accept that just because it's DC doesn't mean it should be cheap. We are not running DB schemes for 10 basis points, so why are we running DC schemes for 10 basis points?"

Dawes also doesn't understand the fee levels people charge, but there is one charge that stands out for him. "I used to be on a trustee board and philosophically, I struggle with performance fees," he said. "I don't see why people charge them in the DC world."

But Humble is more open to the concept. "Fundamentally, this is alignment of interest for the underlying managers," she said. "We are not talking about old-style active management. We are talking about private markets and if there is a much lower standard fee, I'm quite open to that."

Clark's problem with performance fees in DC is inter-generational fairness. "You cannot control when people are going in and out of the fund. That is something, philosophically, I struggle with," she said. "It is challenging."

This is a timely discussion, as the regulator is working to push trustees away from just looking at cost and redefining value to look at net returns.

> **"We are not running DB schemes for 10 basis points, so why are we running DC schemes for 10 basis points?**
>
> Naomi Clark, USS Investment Management

For Bhardwaj, it is not about looking at fees but being confident that private markets will generate better net returns for members. "If we are confident in the underlying investment rationale, fees are part of that, but it is only one side of the coin," he said.

The regulator's value-for-money consultation probably means all schemes will have a traffic light system. "This will force schemes, if they are not holding private markets, to be clear in justifying why they are not taking that approach."

Time horizon is also important when looking at value and returns, which is another difference between DB and DC. "People are a little more short-termist with DC performance relative to DB," Clark said.

"We have been doing this for a long time and there have been good periods and bad periods," she added. "Since I look over 10 years ago, it has been a great story, but that is not always the case over five or two years."

That mindset has to change, Bhardwaj said. It is difficult comparing the returns of master trusts which have a J-curve effect with those which don't. "It is going to have a greater governance burden on trustees and providers," he said.

Waldron points to life insurance companies, which have been investing in private assets for decades, and the net of fees returns they make. "Having DC being different beggars' belief. It doesn't make any sense that people who are relying on these pots for retirement should have a lesser choice of investment options."

It is a point picked up by Humble. "It is basically saying you can only invest in one part of the market but not the other," she said.

But if the purpose of saving for retirement is to beat inflation so pensioners have enough to live on, then a growing part of the financial universe is private, Waldron said. "It ties in with beating inflation, because otherwise you are only investing in a sub-set of the economy, and it is not the biggest sub-set at that," she added.

Premium markets

Aside from diversification, one of the benefits of private markets is the illiquidity premium investors can earn from holding such assets. But they need to tread carefully.

The issue is that the premium can "shrink by its nature", leaving a singular allocation to a single manager particularly vulnerable. "If the spread collapses, you are legally committed to it," Dawes said. "It is the old-school way of allocating to private markets which causes the problem. Hence why active asset allocation is important."

He added that in credit an illiquidity premium is offered in a variety of asset classes from social housing and corporate loans to infrastructure and commercial real estate.

Indeed, the portfolios BNP Paribas AM manage generate around 9%, one of which is an investment-grade portfolio. "Compare that with investment-grade corporate bonds, and it is doing pretty well. So the spreads are there," Dawes said.

"But one of the lessons we have learned is don't apply DB thinking to DC in the way you allocate to private markets. You need to be a bit more innovative."

Dawes uses US mid-market loans as an example of where the returns are good, but during Covid the market collapsed and there was no origination. "If you made a static commitment to that asset class then you sat on your hands for two years as you couldn't get any money in the ground.

"Being able to turn that sleeve off and move to something else is quite valuable," he added. "It could add up to 150 basis points of excess return to members."

Dawes then turned to people who say they are getting better returns from a specialist manager. "How is that possible?" he said. "They can't be generating more return, unless they are taking more risk or investing in non-core assets.

"If you bid on an infrastructure asset, for example, the lowest bid wins. If you are a specialist manager generating superior returns, then you have to be taking more risk or applying leverage."

> **"It is the old-school way of allocating to private markets which causes the problem.**
>
> Philip Dawes, BNP Paribas Asset Management

This impacts how managers are assessed. "You are not comparing apples with apples if one is applying leverage or if one's taking more risk than the other."

Dawes likes infrastructure and commercial real estate as they offer contractual returns with low volatility. "That is not the same if I buy a utility bond, for example. Some people drop it in their infrastructure allocation, but it's a corporate bond, not infrastructure.

"You have to be careful when assessing managers. What are they buying? Is it infrastructure or something else? And can you compare A with B?"

Waldron said that the premium to be earned from investing in illiquid assets might be a complexity premium or an access premium, but it is "absolutely there".

Although she agreed that the premium can "wax and wane". Using the social housing example, when the government

changes how much rent housing associations can charge, it changes the behaviour of that pocket. "The ability to invest across the private credit asset class, looking at what has good value at any given point in time, is valuable."

But for Clark active asset management is the answer to generating premium returns, but it is not just about the financial returns. Where USS owns large direct assets, like Heathrow Airport, it will take a board seat and invest in the assets. "There is good value creation to be had there in a way that you don't have with listed assets.

"We are returns led, but if we can take an active role in an asset and help, for example, Moto increasing their electric charging points, that is a positive benefit you don't have in public markets," she added.

Liquid illiquids

"The liquidity of the asset and the liquidity of the fund structure are two different things as well," Waldron said.

"DB schemes selling illiquids because they are having problems coming out of closed-ended fund structures, is not necessarily the same as the asset. Not all private assets are illiquid. There's a range of liquidity within these markets.

"DC schemes going into a series of closed-ended finds will have a different experience than going into structured funds designed for that purpose, which will utilise the fact that there are different levels of illiquidity," she added.

Dawes then pointed out the irony that although these are illiquid assets, if investors don't manage the capital calls, redemptions and FX hedging coherently, they become more liquid than some people would like. "Very quickly you can end up with a 20% cash drag on your portfolio because of the amount of cash that is being generated by the underlying asset," he said.

"The irony is not in generating a liquidity buffer for DC investors, it is minimising and keeping it low. Otherwise you destroy the purpose of going into these assets, which is to farm and harvest the illiquidity premium. If you are not careful, you end up sitting on cash."

Sharples suggested that it is probably exacerbated by the contributions' schemes receive, which they have to find a home for. "There is quite a lot of liquidity around.

"The one scenario we are talking through is if you are a multi-employer scheme and a big employer pulls out, that is where you could get into difficulty if you have limits in terms of how much you could realise in any quarter," she said.

"Those will be relatively unusual structures, so it feels doable. That is something we probably haven't tackled yet as an industry," Sharples added.

No silver bullet

The conversation then turned towards access, which brought up the theme of long-term asset funds (LTAF), vehicles designed to allow life platforms to invest in private market assets.

"With so many DC schemes on these platforms, it is fantastic that there is now this solution," Clark said.

Bhardwaj described it as a good first step, but questioned if, as master trusts scale, they will be using LTAFs in 10 or 20 years' time. "I suspect a lot of them will go down the approach of holding their assets in custody, which will provide greater flexibility and oversight," he said. "For where we are now, LTAFs give trustees the protections they need."

Bhardwaj reminded the panel that one of the benefits is that investors are permitted to borrow up to 30% of the LTAF's net asset value to meet any redemptions.

> **"There is now a contingent of asset managers who understand DC.**
>
> Veronica Humble, NatWest Cushon

"It gives trustees the toolkits they need to ameliorate some of the concerns around liquidity," he said. "But there is an inherent inefficiency built in because you have to hold the chunk of your liquidity within the LTAF, whereas you already have an abundance of liquid assets outside of the LTAF.

"It is not an optimal solution, but for where we are now, it's good enough," Bhardwaj added.

Dawes is more cynical about such vehicles. "It is not a silver bullet, that's for sure."

What frustrates him is that if it's an LTAF, people will buy it regardless of what's under the bonnet.

Investors need to pay attention to what underlying assets are being purchased, what the strategic asset location of the fund is and how they are dealing the illiquidity. "An LTAF is an LTAF



until you get huge dispersion of performance across them. So it is not a silver bullet," Dawes said.

Sharples gets irritated when people ask her when they are going to invest in an LTAF. "It is almost like it is the new asset class, but it's not. But it is a good first step in that it has got us going, has pushed us off the line."

NatWest Cushon seeded the first LTAF, which was for Schroders, with Humble saying that such vehicles have unlocked everyone's appetite. "Fundamentally, illiquid assets are not that difficult. You don't have day-to-day trading. That's not bad. It sits there. You only do something with them a few times a year.

"We are moving into LTAFs fitting into standard systems," she added. "I'm wondering to what degree we will get more innovation around that now everyone realises LTAFs are not a silver bullet and they will want a bit more tinkering within it."

Sustainable assets

Many private markets are real assets and are therefore vulnerable to the physical risks of climate change, such as flooding.

Reports claim that implementing ESG principles into private companies can be challenging as they are not required to make the same disclosures as their listed peers. While some of the social impacts of private assets might be obvious, such as building affordable housing, when it comes to making a positive environmental impact the lack of consistent and comparative data is often cited as a problem.

But the reality is quite different, according to Clark, especially if the assets are directly owned. "You have more control, more access and the ability to implement your own policies and views," she said. "For us, it is one of the significant benefits of investing in private markets assets."

ESG is not a new concept in private market strategies. For years it has been one of the risk factors USS' managers consider when making investment decisions due to the huge ESG risk physical assets carry. Indeed, USS has responsible investment specialists sitting within its private markers deal team.

There are regulations designed to help investors collect information about a corporate or asset's ESG performance. But Waldron finds that they are too focused on risk and a lot of the reporting is quite prescriptive, likening it to trying to fit a "square peg in a round hole".

"The superpower of private markets is not risk mitigation; it is positive sustainable action," she said. "It is about being able to make a difference, either environmentally or socially.

"They are doing good things. It they are not just protecting against bad things. That is where private markets are probably more interesting," she added.

> **The challenge for master trusts is that a lot of their clients are buying on price.**
>
> Joanna Sharples, Aon DC Solutions

Recycling technology and reworking buildings to make them more environmentally friendly are some of the investments sitting in M&G Investment's portfolios.

"They are not about data and reporting," Waldron said. "They are about making a difference that aligns to the end members, because it is their world we are investing in."

So it appears that positive environmental and social impacts could be more achievable if holding private assets directly. "The requirements placed upon funds to meet SDR or SFDR regulations can be restrictive," Waldron said.

To prove this, Dawes gave an example of when BNP Paribas AM was approached by a corporate which wanted to be aligned to the energy transition. The sustainable development goals they wanted to focus on concerned the ocean, freshwater, renewables, industrials and electric vehicles.

BNP Paribas AM then built a portfolio after considering 60 sub themes within those sustainable development goals. Part of the mandate was to identify how best to access these themes.

"Obviously, you can get some of them through listed markets, but if you want to do carbon capture through listed equities you have to buy Exxon Mobil, which doesn't feel right.

"You have to go through VC and private equity to access some of these things," he added.

The net-zero portfolio BNP Paribas AM built for the corporate was 40% illiquid. "That is where we landed, which follows the 60-40 role you see echoed across the DC market.

"Not only do you get more control over these assets, but you can also be more hands on, you can write KPIs into the contractual terms when you are lending to people in the credit space," Dawes said. "It also gives you access to things you can't find anywhere else."

> **"The superpower of private markets is not risk mitigation; it is positive sustainable action.**
>
> Jo Waldron, M&G Investments

Putting the other side of the argument, Bhardwaj said that when he and his fellow trustees are compiling climate reports and TCFD statements, they almost discount any private market allocation because they know they are not going to get anything back from the manager in terms of carbon intensity reporting.

Replying to a chorus of claims that he is using the wrong manager, Bhardwaj said this is not about a specific manager. "Maybe trustees or their consultants aren't pushing hard enough," he added. "If there is going to be a democratisation of private markets that needs to change."

The road ahead

The roundtable was brought to a close by a look at the future of DC allocations to private markets.

Dawes would not be surprised to see increased exposure to private equity. He also predicts lower fees to invest in alternative assets and that there will be greater ESG alignment. An improvement in another area is also expected.

"The provision of data isn't ideal in private markets. It's better than it was, but that will also improve," Dawes said. "There is a geographical element to that as well, which also impacts fees."

Dawes then touched on diversified private markets portfolios, specifically people calling them the new diversified growth fund. "They are waiting for them to fail, but these are different beasts," he said. "They are contractual returns. You are not relying on the skill of the manager to asset allocate. You are relying on their ability to originate quality assets."

He added that when people allocate to private markets they will look at the strategic asset allocation and what it is designed to do, not that it is an LTAF. "They need to look under the bonnet, look at what the manager is going to be buying on their behalf," Dawes added. "I've seen it time and time again, people over promise and under deliver on spreads."

Another issue is that because spreads are cyclical, managers raise too much capital and will then loosen their credit terms. "That is not in the interest of members."

Dawes added that when going into private markets, be clear about what you are investing in, and decide on your definition of infrastructure, for example, and stick to it. "Don't let it creep. Don't let it move just because you have dry powder burning a hole in your pocket.

"I would love to see private markets more readily available but with a focus on quality, as opposed to just getting money in the ground for the sake of it," Dawes said.

Bhardwaj agreed, pointing to the potential risk of 12 master trusts all looking to deploy capital at or around the same time. Then there is the need to select a top quartile manager, due to the vast dispersion of returns. "Well, we can't all access top quartile managers.

"There are going to be players that have managers which outperform and underperform. It is important that this shouldn't be a big bang approach. It needs to be done in a measured way and in a way that is sensitive to price."

In other areas, Bhardwaj expects to see a gradual move away from life wrappers to custody, which will take time due to a lack of the right expertise with master trusts.

He also anticipates a move away from multi-asset LTAFs and towards holding individual sleeves, which again will take time.

Sharples had the final word in our discussion by raising a good point that there is a lot of focus on master trusts, but not much talk about contract-based schemes, which are half of the DC market.

"I get worried that some of the legacy members are underserved. They get swept under the carpet, and there are quite a lot of them.

"I would like to see private assets coming to benefit them, not just the master trusts," she added. "It should go across the board. That is what I would like to see. I just hope it happens."

M&G Investments

BNP PARIBAS ASSET MANAGEMENT

JERSEY: THE HOME OF ALTERNATIVE CAPITAL

The island is welcoming a growing number of private equity, property and private debt funds.

Jersey offers fund managers more than just an attractive tax regime. It has to if it wants to stand apart from jurisdictions such as the Cayman Islands.

Jersey's strategy to entice fund managers to its shores has seen it evolve into a specialist finance centre for alternatives. Indeed, 88% of funds registered on the island are managing illiquid assets. This means it services more than 2,390 funds, which invest in a range of asset classes, including real estate, private equity and hedge funds.

Private equity and venture capital are the primary asset classes, collectively representing 47% of regulated funds registered in Jersey. Real estate funds rank a distant second at 6.6%.

But one of its fastest growing asset classes is private debt, where the net asset value (NAV) of such funds has increased by around a fifth (21%) in the past two years.

All of this has resulted in the combined NAV of regulated funds registered in Jersey jumping by more than 40% during the past five years.

Why Jersey?

The island's regulated fund and services industry is worth around £458bn. But this is not its true value. The figure does not include the Jersey Private Fund (JPF), a regime for sophisticated investors.

The Jersey Private Fund, or the JPF as it is popularly known, was launched in 2017 and today more than 700 such funds have been established.

The regime targets spinouts and startups as well as small managers looking to scale up. Such flexibility is why some managers choose to domicile their funds on the island. "It is not solely about the numbers when it comes to: 'why Jersey?' Managers look for flexibility of product and the JPF is definitely that," says Nicola Le Brocq, a London-based director of Jersey Finance, an organisation that promotes the island's financial services industry.

Stability is another selling point. "The island is a stable jurisdiction, politically and fiscally," Le Brocq says. "It also offers a minimal change outlook from tax, legal and economic perspectives."

Another draw is the expertise of the 14,000 people administering and servicing funds. "Then there is a good community of non-executives," she adds. "They have extensive knowledge of various asset classes."

A simplified offering

"Jersey has always been innovative," Le Brocq says, as she looks back at her career, which started at the island's regulator more than 20 years ago.

"I have seen an incredible amount of innovation and progress during that time," she adds.

Yet there's no secret to Jersey's success. They have just built on the foundations of what managers' need to achieve a successful fund launch.

Being a tax-neutral jurisdiction helps. It makes Jersey less complex than some of its competitors, offering operational flexibility without the need for complicated tax structuring. "That is an evolution that has considered the needs of investors," Le Brocq says.

But tax-neutrality is not unique. "Onshore jurisdictions offer similar arrangements, yet Jersey is a much more simplified offering," Le Brocq says.

"There is usually more red tape if you select onshore jurisdictions for that type of thing," she claims.

Such a "simplified offering" has not been achieved in isolation. "The regulator, industry and government do a good job at futureproofing our fund product and services offerings," Le Brocq adds.

Jersey's approach to keeping up with the market's latest trends and the needs of fund managers has seen it not only welcome managers based in the UK, but also those in the Middle East, Asia and the US.

"Cayman is not the default anymore," Le Brocq says. "Internationally, investors or general partners are looking further afield and not just going with what they know."

With this in mind, Jersey's Limited Liability Companies (LLC) came into force on 1 September 2022 "to meet the needs of US managers" says Le Brocq.

Democratisation

Developing a deep understanding of the nuances of servicing alternative investments has enabled Jersey to push the boundaries of the market. This makes it well placed to support one of the largest trends in the private funds industry: the democratisation of private markets, which is creating a broader investor base through changing the way such assets are accessed.

"Jersey is at the forefront of this transition in terms of how the digitalisation of assets will transform investments and enhance transparency and increase efficiency," Le Brocq says.

"Despite the challenges in bridging the digital and physical realms, particularly for complex cross-border ownership structures, the trend towards digitalisation is definitely gaining momentum," she adds.

Tokenisation is of interest to the island as Le Brocq predicts that it will become commonplace along with other forms of digitalisation by the end of the decade. "It is important for financial services jurisdictions to adapt and evolve with this," Le Brocq says.

Jersey has a good track record in this area having supported virtual assets and

Nicola Le Brocq

tokenisation for some time. Earlier in the year, it published regulatory guidance for virtual assets and intends to provide further clarity around the island's capabilities in supporting and servicing this need.

Clean money

Money laundering is an issue that puts financial services centres under great scrutiny. Jersey has what Le Brocq describes as a "robust" anti-money laundering framework that pre-dates her time at the regulator.

Indeed, Moneyval, the Council of Europe's anti-money laundering body, agrees with her assessment.

In July, the island received a favourable review from the organisation on the systems and processes that help prevent financial crime in the jurisdiction. "[The review] is not just about the implementation of the framework, but its effectiveness," Le Brocq says.

"It was a highly positive report," she adds, one that shows Jersey is "largely compliant" with all but one of the 40 recommendations set by the Financial Action Task Force (FATF), which endorsed Moneyval's findings. "It solidified our position at the top in terms of the other jurisdictions who have undergone this evaluation," Le Brocq says.

"All in all, the island is well placed around anti-money laundering."

Trends and tailwinds

Looking to the future, the investment case for alternatives is bullish. Private equity and venture capital is Jersey's "bread and butter" in that during the past few years it has won a considerable market share. Indeed, the NAV of private equity and venture capital funds on the island increased by 10% during 2023.

There could be further gains on the way. A tailwind for private equity and the support Jersey offers is London being Europe's centre for managing such assets.

Le Brocq points to the uncertainty around potential tax changes by the UK's new government as "an elephant in the room" that is contributing to the growing interest amongst private equity investors to relocate to another domicile. "We are seeing a lot of interest from UK managers in establishing a physical presence in Jersey," she says.

Other markets to watch include private debt and real assets given the trend within private markets for investors to diversify, a result of a greater number of general partners fundraising in the past year.

Then there are secondaries, which are "keeping law firms busy", Le Brocq says. "The huge demand for secondaries is anticipated to continue well into 2025 and beyond."

Keep on moving

Jersey has always been innovative and agile, which goes with the territory for smaller entities. "It is important for fund services jurisdictions to be nimble enough to move with what's happening in the market and what investors are looking for," Le Brocq says.

Futureproofing their offering includes constantly assessing the expertise within their teams and the effectiveness of the technologies they use.

Then there is meeting the growing demands of managers. A big current theme is exploring the virtual asset space and tokenisation of real assets, which is reshaping the capital raising landscape. So it is an exciting time but is not without its challenges.

"We need to establish the right regulatory framework to protect investors while not restricting innovation," Le Brocq says. "That is the balance all jurisdictions need to strike."

Remaining relevant

The challenge for fund services jurisdictions like Jersey has always been to remain relevant.

"Those who fail to evolve, will simply regress. Jersey has a pretty good longstanding forward-thinking approach," Le Brocq says.

As an example, she looked back to when financial centres within the European Union moved into the retail area under the UCITS directive. Yet Jersey shifted towards alternative funds instead, targeting sophisticated investors so as not to compete with UCITS, which is now a huge regime.

This prompted the successful introduction of Jersey's expert fund regime.

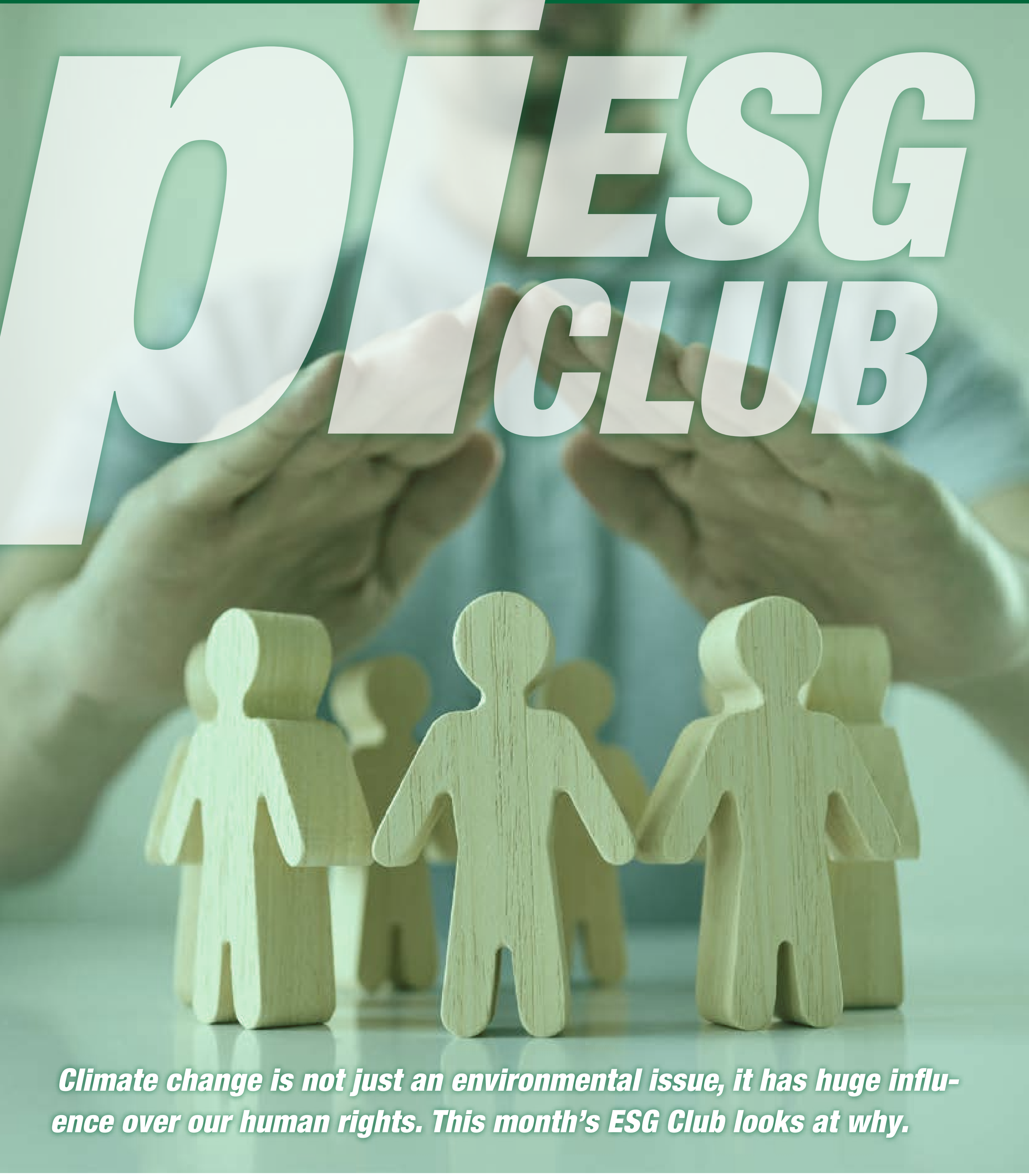
"That was in 2004 and has helped position Jersey as a strong alternative investment funds market player and provided a platform on which we built our reputation."

That has, over time, developed into a wider spectrum of fund solutions. "So from highly regulated, widely offered retail funds to lighter touch options for smaller groups of sophisticated or institutional investors. All of which is backed up by highly experienced fund administration and corporate services firms within the island."

As a fund jurisdiction, Jersey's story has been one of innovation and modernisation. It appears that as the needs of fund managers evolve, so will the island's service offering.

Jersey Finance

pi ESG CLUB



Climate change is not just an environmental issue, it has huge influence over our human rights. This month's ESG Club looks at why.

Members

BlackRock

BNP PARIBAS ASSET MANAGEMENT

LGIM

NEWTON Investment Management

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

RESEARCH REVEALS BIG BANKS ARE FALLING SHORT ON CLIMATE TARGETS

Share Action uncovers disappointing sustainability targets at some of Europe's largest lenders. *Andrew Holt* reports.

New analysis has exposed what looks like unambitious and incoherent climate targets at Europe's richest banks.

This means these lenders are unlikely to succeed in shifting enough financing away from fossil fuels and towards renewable power, green infrastructure and technologies at the speed and scale needed to prevent a dangerously overheated world.

The research by responsible investment campaigner Share Action, which analysed targets for reducing emissions from financing activities and those for increasing sustainable investment, found that overall banks' decarbonisation goals are too narrow.

They also discovered that their sustainable finance targets are not rooted in "robust methodology" and are not sufficiently aligned with one another.

Share Action's analysis showed that 18 of the continent's largest 20 banks, including HSBC, Barclays and BNP Paribas, are not on track to meet the $10-to-$1 ratio of green investment to fossil fuels investment the International Energy Agency says is needed by 2030.

It found that just Natwest and Nordea can realistically be expected to meet this milestone based on the sustainable finance targets they have set.

Despite sustainable finance being a critical driver to achieve emissions reductions, Share Action said that banks are "inconsistent" in their approach to target-setting, making it difficult for the public, regulators and investors to judge the "real impact" of banks' climate action efforts and be able to hold them to account.

Even some of the largest, most ambitious-sounding green finance targets are in reality small relative to a bank's size, Share Action believes.

For example, the campaigner cites that HSBC's goal of allocating up to $1trn (£770bn) towards sustainable investment by 2030 is just 1.8% of its total assets, while for Barclays' it's just 3.2% of its assets.

Different journeys

Five banks – BBVA, CaixaBank, Commerzbank, Deutsche Bank and HSBC – have set sustainable finance targets that cover their banking and asset management activities, but keep these activities separate in their decarbonisation targets, Share Action said.

Banks set decarbonisation targets over five years and sustainable finance targets, on average, over 10 years.

While almost all decarbonisation targets by banks are based on a clear methodology, just 13% of sustainable targets are backed by transparent, public methodology, Share Action claims.

All 20 banks have set at least one sectoral-specific decarbonisation target.

Vital role

Yet only nine banks have also set one for sustainable finance that illustrates how they are funding sectors that are crucial to a successful transition, such as renewable power and green technologies.

Banks rarely provide a breakdown for how much sustainable financing they provide to these sectors, Share Action said.

Xavier Lerin, senior research manager at the campaigner, said: "Europe's biggest banks have a vital role to play in financing the transition to a low-carbon economy, such as scaling up renewable energy, making real estate energy efficient and supporting important industries to decarbonise."

However, he added: "Our analysis shows that in the majority of cases, the climate targets banks are using as a roadmap to transition are not fit for purpose, which is putting at risk our ability to protect society from the worst impacts of climate change.

"We urgently need banks to set more ambitious and coherent targets that transparently map out how they will live up to their commitment to finance the renewable power, green infrastructure and technologies needed to protect people and our economies."

Responding to the research, a spokesperson for Barclays said: "Barclays is delivering against its target to facilitate $1trn [£776.7bn] of sustainable and transition finance by 2030 – a larger target than many peers, when viewed relative to total assets."

portfolio institutional also contacted HSBC and BNP Paribas for comment on this issue, but at the time of printing, neither had responded.

Investor concern over how banks are falling short on green finance is a rising trend.

Investor coalitions signed statements addressing this were read to the boards of Société Générale and HSBC at their annual general meetings earlier this year.

As a next step, Share Action is writing to the chief executive of each bank with recommendations about how they can set effective climate targets that will help them reach their net-zero goal.

In particular, it is urging banks to set sector-specific targets around sustainable finance that are grounded in science.

The banking standards team at Share Action has partnered with asset managers, asset owners and NGOs to call for Europe's largest banks to phase out financing to polluting activities and instead increase the flow of capital into low-carbon alternatives.

ESG INTERVIEW – LEANNE CLEMENTS

"The goal is to do such a good job that dedicated responsible investment teams are no longer required."

The head of responsible investing at the provider of the People's Pension looks back over her almost 30-year career in sustainability and tells *Mark Dunne* about taking a targeted approach, the benefits of honesty, sharing the workload and serving 6.8 million members.

Today, saving the planet is a sexy job, but what was it like in 1997 when you started working in sustainability?

It was more about compliance and ticking boxes. Back then I was working for a consulting engineering firm doing contaminated site assessments in support of refinancing decisions for financial institutions. That was probably where I got my appetite for the finance sector.

When did you decide that you wanted to save the planet?

It started at university in the early 90s. I wouldn't say it was a grand passion. I studied psychology, but didn't pass the bar in my first year.

At that time, Queen's University started offering environmental science, and I was in the first graduating class. It was a great course and amplified my interest.

I then took a post-diploma in environmental engineering because I struggled with how to apply the course into a real job. As part of that, I did an internship for a consulting engineering firm where I drilled holes and collected groundwater samples. I thought: "So this is how I take all of that academic theory from university and practically apply it."

That was my foray into working for financial institutions. As part of a buy/sell you have to assess any properties. If there is contamination, it's taken off its value.

I did that for 10 years, but by 2007, I felt that if I wanted to move up a stage in my career then I should do a master's degree. So I did an MBA in corporate social responsibility at Nottingham University Business School.

That is when I realised I could take the lessons learned over 10 years, where I was evaluating risk at an operational level, and lift it up to a more strategic level.

Looking at things in a more holistic, macro context is in alignment with my skills. That is what piqued my interest in responsible investment, because I didn't want to abandon the 10 years. I was in my 30s and was up for a career change, but not a complete career change.

Looking back over your career, is sustainability where it should be by now?

There is an assumption that we have mainstreamed responsible investment. But have we?

What has occurred in the past few years is an explosion of products and services within ESG, but the question I would ask the industry is: have the corresponding beliefs moved with them?

If those products and services are moving in one direction, and your beliefs are not going with them, then they don't have a

solid foundation. So we aren't able to withstand shocks, for example, like what is happening in the US with the anti-ESG movement.

There have been a lot of people from the mainstream moving into our field. So I'm not saying there hasn't been advancement, but we need to be honest about the beliefs part of the picture.

You took on this role at People's Partnership two years ago. Why did it appeal to you?

I was in Spain working with the Association of Member Nominated Trustees (AMNT) on a campaign to address systemic barriers to split voting in pooled funds. That contract ended after four years.

I was pretty disgruntled at that point. I wasn't able to advance meaningfully in terms of my professional development, because it is important to me that I'm always learning. In other words, I was reaching a plateau.

So I was looking for opportunities in 2022 with a little trepidation, because I had that experience of not feeling fully integrated into the investment team, like the value proposition of responsible investment wasn't fully embedded.

I was a bit nervous about coming back in, but I talked to a lot of my colleagues in the industry, and they said it has moved on materially enough that the role will be different, and there will be an opportunity to learn and grow. So for that reason, I came back in.

What have you achieved in those two years?

There's no I in team. We have achieved a lot but could not have done it without the senior management's support and our wonderful trustees.

In terms of what we have delivered, we integrated climate-aware funds into the developed equities portfolio. It was £15bn and was the single biggest move in the UK at the time for defined contribution. That took about 18 months to process through various governance committees, so it was a huge accomplishment for everybody involved and a professional highlight for me.

The second is updating our responsible investment policy. The core of the update centered around strengthening our expectations of fund managers. That received good industry feedback in terms of its clarity and transparency. I'm quite proud of that policy.

There are many different pillars of those expectations. First, we look at whether the fund manager is aligned to our responsible investment objectives and beliefs. Then we unpack the governance piece. If it's for a passive mandate, we look at stewardship resourcing. For example, if there's board oversight.

Then we look at voting and engagement. We have expectations across our stewardship priorities of climate, nature and human rights.

So we look at the degree of alignment between those expectations, our net-zero voting guidelines and what our fund managers are doing, to see if there are any gaps.

Then there is the quality of their reporting, because there's a lot of work that needs to be done here, with respect to getting more granular data on engagement.

There is a whole narrative missing from stewardship reporting: company engagement information milestones, progress against them and what are you going to do if engagement fails. We push our managers to improve in that space.

One of five workers in Britain save with People's Partnership. Other than an income in retirement, what are you offering them?

One of the differences of working in a large master trust, is a sense of responsibility to that one in five.

I'm keen to show that we have them at the heart of our decision making on responsible investment.

For example, we have completed a YouGov survey of UK savers. Our intention is to use the findings to shape our stewardship program.

Another area of focus is to create more member-friendly responsible investment content. In other words, our responsible investment policy is technical, but deliberately so, because the primary stakeholders are our fund managers. But in addition to that we want to create a more member-friendly version. A member-friendly version of the TCFD (Task Force on Climate Related Financial Disclosures) report is also coming soon.

You manage £30bn worth of assets. Is it possible to invest such a large amount responsibly?

One of the benefits of where we are in the industry, in terms of greenwashing risk and the anti-ESG movement in the States, is that it will put us in a much more honest place.

Honesty will be rewarded in this new environment. It is taking a staged approach, saying that this is what I'll be able to do by this time, and this, by this time.

It is an evolution, not a revolution. Just being honest that this is a journey, because the goalposts are always moving in terms of data and analytics frameworks.

You are not going to read that we 100% embed ESG into the investment process. This is the kind of statement the industry was making 10 years ago. Now we are in a much more honest place about what we have embedded into which asset class. It is a lot more rooted and grounded now.

100% responsibly? Perhaps not. As long as you are honest about it being a work in progress and evolving your process over time, you will have more credibility in today's market than saying we are 100% invested responsibly.

Back to fund manager standards. You once said that the days of "tea and cake" engagement are gone and you want to see a more targeted approach, routed in robust theory. Is that message getting through to your managers?

You are not going to read that we 100% embed ESG into the investment process.

It's a bit early for that. It's a work in progress. It's just about consistently sending that signal through the monitoring programme. Rome wasn't built in a day when it comes to these things.

It is a progressive responsible investment policy in the sense of it being stretched, but deliberately so.

What I'm hoping to see is that the conversations I'm hearing in the industry around us needing to take a targeted approach, that's rooted in a theory of change, will eventually be embedded into the stewardship approach.

This is why I thought it was important for us to root it in the responsible investment policy so that it's formalised and part of the monitoring programme.

It's part of how we score the managers on how well they answer these types of questions.

It is not something where you snap your fingers and it happens overnight, but conversations are happening.

It is early days, but I can see a positive evolution with respect to it. So let's talk in three years.

How widespread would you say that misalignments between asset owners and their managers are?

It's an interesting word, misalignment. It seems to have resulted in some polarization in the industry.

There is an assumption that we have mainstreamed responsible investment.

Ultimately, what's important here is creating a partnership between the asset owner and the fund manager to strengthen that stewardship chain.

If you use terminology like 'alignment' it can create tensions, which is not what we're looking to achieve.

We're in an interesting phase in stewardship, one of disruption. For years, predominantly speaking, the stewardship proposition was supply-led by fund managers.

What I'm seeing lately is a shift where asset owners are starting to rise in terms of their voice. You're seeing evidence of that through the new stewardship propositions that are being presented by fund managers.

Another disruptor working in this space is the Task force for Pension Scheme Voting Implementation, which I was on when at AMNT.

Seven years ago, no fund manager was willing to talk about it. Well, today the landscape is an entirely different world, and it's creating a lot of disruption.

People have an issue with it, but it is a necessary evolution to where we need to be as we move towards more of a demand-led industry when it comes to that stewardship proposition.

There will be growing pains along the way, but it's necessary in order for us to shift this system to a place where it always should have been, which is demand-led with the asset owners at the top of the chain, being the owners of the capital, driving what they need from their fund managers.

It's an interesting word, misalignment. It seems to have resulted in some polarization in the industry.

What big stewardship issues are you facing?

Where we are failing is we are spread too thin. You just see a heck of a lot of initiatives happening in all sorts of places. What we need to have is that targeted approach.

We expect that of our managers and are clear on the areas we want them to focus on. But what we need to do is share the workload.

There are industry leaders doing good work in targeted areas. A good example is Adam Matthews [Church of England Pensions Board] and his mining work. Railpen on dual-class shares is another pocketed area.

We need more of these focal points and more people leading them like they are. We will achieve much more of a maximum impact, as opposed to us all working in silos, spreading ourselves too thin.

What's your focus going forward?

Building the team. I just hired a new stewardship manager, so we now have three. We're looking to double that in the next few years.

Ultimately, that will allow me to focus more on industry and policy engagement, which is important for the head of responsible investment to do.

Then we are looking to integrate climate beyond developed equities into other markets and asset classes.

We are also looking to embed nature and human rights more formally into our stewardship processes.

When will your work at People's Partnership be complete?

There's tension there. Do I want to be out of a job? I suppose I do. Ultimately, the goal is to do such a good job that dedicated responsible investment teams are no longer required.

And we are so successful in industry and policy engagement, that we create a sustainable financial system, and then everything will work the way it should by making me redundant.

Will it happen before I retire? No. But there will be work to do over the next 10 to 15 years.

LEANNE CLEMENT'S CV

Sept 2022 – present
Head of responsible investment
People's Partnership

Oct 2021 – Aug 2022
Head of stewardship UK/EU
Carbon Tracker

Mar 2017 – Aug 2021
Campaign manager
Association of Member Nominated Trustees

Apr 2016 – Sep 2016
Responsible investment manager
Pension Protection Fund

Jun 2014 – Mar 2016
Responsible investment officer
West Midlands Pension Fund

Jun 2013 – Apr 2014
Responsible investment consultant

Nov 2011 – May 2013
Responsible investment officer
London Pensions Fund Authority

Mar 2009 - Jul 2011
Researcher – proxy voting and shareholder services
PIRC

Jun 2008 – Sept 2008
Sustainable supply chain internship – MBA dissertation
Arcelor Mittal

Apr 1999 – Aug 2007
Intermediate to senior project manager
Exp Global

Jul 1997 – Apr 1999
Environmental Consultant
AMEC Earth & Environmental

HUMAN RIGHTS: SOME RIGHTS, MANY WRONGS

Human rights are not just a social issue, so the investment risks are huge. *Mark Dunne reports.*

Bad publicity is a great motivator, especially if it involves rubber gloves.

Back in 2021, Top Glove, which makes more disposable gloves for doctors, nurses and surgeons than anyone else in the world, found itself in trouble with the NHS and the US government. The authorities in its home country Malaysia uncovered evidence of forced labour and insufficient Covid protections in their factories.

Its customers were not happy. In fact, the US banned its products from being used in the country, which mean that 22% of its revenue disappeared. Investors were equally unimpressed and a planned $1bn (£771bn) stock market listing in Hong Kong was scrapped.

The US ban was lifted after it convinced the authorities that working conditions had improved. Compensation totalling $30m (£23m) made to those effected also helped reverse the decision.

Loss of revenue can result from being accused of exploitation and can be rectified by improving conditions for your employees, but repairing a damaged reputation could take longer. A clear example of why human rights is a major risk for investors.

Indeed, the health and safety of workers, eradicating forced and child labour and displacing communities are areas where institutional investors should be using their influence over the corporates sitting in their portfolios to improve the standard of human rights in the supply chain.

This is a huge issue. Around 27.6 million people are believed to be victims of forced labour globally, according to Anti-Slavery International, a charity. It also claims that a fifth of global cotton production is linked to slavery in China.

Making a stand

A range of industries, from fashion to mining and manufacturing have found themselves at the centre of human rights scandals. Many are repeat offenders.

The pressure on institutional investors to hold companies to account if they are infringing these rights is growing. And many are taking action.

Blackrock was an investor in Top Glove when it hit the headlines over the forced labour in its factories. The asset manager decided to voted against the re-election of directors sitting on the company's board. Blackrock was using its influence on behalf of the pension schemes it manages capital for to drive change at the company. But this isn't just about ethics.

In an Edelman Trust Barometer survey of 700 global investors, 90% agreed that companies prioritising ESG integration represent better opportunities for long-term returns than those who do not. And the market share of those thinking this way is expected to move in the right direction.

Indeed, global ESG assets surpassed $30trn (£23trn) in 2022 and are expected to be worth at least another $10trn ($7.7trn) by 2030, which would be a quarter of all assets under management, according to Bloomberg Intelligence.

The eye of the storm

Being at the centre of an exploitation scandal is a concern for business leaders on both sides of the Atlantic, if surveys are to be believed.

Indeed, research carried out last year by Proxima, a consultancy, found that most chief executives in the UK and the US are aware of the risks that could be lurking in their supply networks.

The survey of 2,000 companies with at least 50 employees found that 69% of their leaders are concerned about benefiting from human rights abuses in the companies they contract services from.

Proxima's executive vice president, Simon Geale, said at the time that addressing human rights issues across the supply chain is a "huge challenge" for businesses and is high on the agenda for their leaders.

"We've seen a number of businesses fall victim to human rights issues," he added, "and as we see increased scrutiny from customers and regulators, supply chain transparency is going to become increasingly critical.

"This is the emerging priority for CEOs at a time when business leaders are spending more time than ever tackling supply chain issues."

Unsurprisingly, the figure for leading retail businesses is higher, at 79%. This reflects the greater scrutiny the fashion industry is under following a series of scandals involving those making clothes to be sold on high streets across the developed world.

There was Rana Plaza, the eight-storey building in Bangladesh that collapsed back in 2013 taking the lives of more than 1,100 people with it. Substandard materials were used in the construction of the building, which was not designed to be a factory and more floors were then added than were deemed safe. It made clothes for companies including Primark.

It was not the only example of a disaster in Bangladesh's manufacturing sector, as a fire hit another factory in the country a year earlier. Faulty wiring was named as the likely culprit.

Safety standards have improved since the disaster. They have had to if Bangladesh is to maintain its position as the world's second largest clothing maker behind China. In 2022, the industry employed 4 million people and was worth $42.6bn (£32.8bn) to the economy.

Boohoo

It is not only in the developing world where institutional investors need to be vigilant against workforce exploitation. They have been closer to home with one particular scandal involving online clothing retailer Boohoo.

As businesses struggle to meet demand for what is known as 'fast fashion' – mass produced low-cost garments sold online and on Britain's high streets – at least one supplier had cut corners. In 2020, undercover reporters found that a factory in Leicester making clothes for the company was paying workers as little as £3.50 an hour, less than half of the £8.72 minimum wage at the time. They were also operating as usual during the Covid lockdowns, putting its staff at risk.

The home secretary at the time, Priti Patel, launched a modern slavery and human trafficking investigation. A barrister-led review backed up the journalists' claims of low pay and poor working conditions and labelled Boohoo's monitoring of their supply chain as "inadequate".

Those holding Boohoo's stock also suffered. Shares in the company plunged by 44%, wiping off more than £2bn of value.

There have since been allegations that the changes made since the story broke have not been adequate.

Full disclosure?

Most large companies have divisions that tackle risks such as anti-corruption or cybercrime, so why not human rights?

In North America, only 85% of companies with human rights commitments publish such disclosures related to their supply chains. This has risen from 56% in 2017, so it is moving in the right direction, but why isn't the figure 100% if they have a policy in this area.

One reason could be due to the visibility of the supply network, which, if it involves companies in the emerging world, might be difficult to monitor.

"A key concern is poor transparency of organisational supply chains, which is hampering progress on these topics – and many CEOs bemoan their inability to make informed decisions and manage risks based upon supply chain data available today," Geale says.

Upholding human rights often relies on voluntary agreements and some regulation, which seeks to improve corporate practices.

Legal frameworks that require companies to report on human rights and environmental issues include the European Union's Corporate Sustainability Reporting Directive (CSRD).

Then there is the UN Guiding Principles on Business and Human Rights. Principle number 17, for example, calls on companies to undertake human rights due diligence to identify, prevent, address and mitigate adverse human rights risks and impacts.

However, a survey of 1,300 corporate executives in 13 countries found that more than 70% lacked confidence in their own ESG reporting, according to business data specialist Workiva. That was two years ago, so it is hoped that confidence is growing.

No guarantees

Investing in specifically labelled sustainable investment products may not save investors from reputational damage when it comes to human rights abuses.

The Business & Human Rights Resource Centre had a shock when they looked into the shareholders of the companies that funded and equipped Myanmar's military, which the UN has accused of crimes against humanity. They found that more than $13bn (£10bn) of capital flowed from 344 ESG funds into 33 of those companies, which included weapons manufacturers, energy giants, tech companies and even Facebook, which was accused of facilitating hate speech on its platform against the Rohingyas, a minority being persecuted in the country.

But ESG is not about investing in companies with high ethical profiles. It is about changing badly behaved companies, improving their practices and how they make money. If necessary, the goal is to make them greener and fairer.

Spotting such abuses is on the agenda for Abrdn. The asset manager believes a focus on human rights provides a valuable insight into a company's risks and opportunities.

There are two approaches it uses to assess and integrate human rights risks into portfolios.

The first is a top-down assessment of the human rights environment in a given country or region, particularly drawing on political and social research, to understand the potential impact on potential investments. Proprietary ESG frameworks and indices are used to identify key rights at risk.

We've seen a number of businesses fall victim to human rights issues, and as we see increased scrutiny from customers and regulators, supply chain transparency is going to become increasingly critical.

Simon Geale, Proxima

Then there are bottom-up assessments of how companies face human rights issues depending on their activities. For instance, land rights and community consent are more relevant for a mining firm, while the right to privacy would be more of a priority for a software provider.

It's not just about the S

But human rights are not just about how much an employee is paid or the number of breaks they are allowed. It is an issue that stretches far beyond the social pillar of ESG.

Indeed, cutting the amount of carbon in the atmosphere could help in the fight to ensure a higher quality of life, as the two are interlinked.

Human rights include a right to live in a clean and healthy environment free from pollution and hazardous weather patterns. It is also a factor in not just building a greener economy but to facilitate a just transition, too, where communities are not decimated as livelihoods disappear.

But it goes further than that. In 2019, a Dutch court ordered the government to cut carbon emissions, describing climate change as a threat to human rights. A few years later, Brazil's supreme court declared the Paris Agreement a human rights treaty. Then in 2021, the UN passed a non-legally binding resolution declaring that a healthy environment is a human right.

So climate change, nature loss, pollution and waste are human rights abuses as they are major threats to humanity. The heatwaves, droughts, floods and wildfires climate change create are a threat to our food and freshwater supply, our health, our sources of energy and drives migration.

At the time the UN's resolution was passed, Inger Andersen, executive director of the UN Environment Programme, said: "This resolution sends a message that nobody can take nature, clean air and water, or a stable climate away from us – at least, not without a fight."

New direction

It is clear that in today's market, companies cannot afford to ignore human rights abuses in their supply chains or, indeed, within their own operations. Employing risk assessments or using a compliance programme could be crucial to helping companies maintain strong relationships with their clients and suppliers, make their operations more efficient and to guard their reputation.

Aside from helping to make the world a better place, it could also avoid causing social unrest in economies where an enterprise is exploiting its local workforce.

If you need convincing, just ask the investors who were exposed to Boohoo when it made the front pages over how its workforce was treated. It could make for an interesting conversation.

INVESTING IN THE UK: CARROT OR STICK?

How can the government encourage more retirement schemes to back Britain? *Gill Wadsworth* finds out.

In her first speech as Chancellor of the Exchequer, Rachel Reeves was emphatic that private capital would be essential in driving the new Labour government's growth ambitions.

Reeves was also clear that the nation's retirement plans will be firmly in the government's crosshairs as target investors in domestic projects to achieve that growth.

Speaking four days after July's general election, Reeves said: "We will turn our attention to the pensions system, to drive investment in homegrown businesses and deliver greater returns to pension savers."

Then in August, the government announced the Pensions Investment Review with the aim to "boost investment, increase saver returns and tackle waste in the pensions system".

The first phase of the review will focus on investment and report initial findings later this year ahead of the introduction of the Pension Schemes Bill. The second phase will start later this year and alongside investment, will consider further steps to improve pension outcomes, including assessing retirement adequacy.

A call for evidence on the first phase closed on 25 September and ahead of the official government response, *portfolio institutional* has collated views from key pension and investment industry stakeholders to garner appetite for initiatives that will drive local government pension schemes (LGPS) and defined contribution (DC) funds into UK assets.

Overstepping the mark

The Pensions Investment Review asks whether there is a case for establishing additional incentives or requirements aimed at raising the portfolio allocations of DC schemes and LGPS funds to UK assets.

If the government were to incentivise trustees to take such investment decisions on their members' behalf, there are immediate questions about a potential conflict with fiduciary duty.

Lizzy Holliday, director of policy and public affairs at master trust Now Pensions, says: "Trustees ultimately bear the responsibility to ensure that an investment is in the best interests of the members within the scheme, and we consider this system provides the appropriate safeguards for members.

"It's essential that government interventions don't overstep the mark by assuming the role of trustee," she adds.

Holliday continued to explain that formulating policy which influences pension investment strategies is inherently complex and warns that overly prescriptive measures that limit trustee decision-making raise questions about accountability for outcomes and redress.

"Policymakers should also be mindful of the broader market impact, such as inflating prices artificially and causing asset bubbles," she says.

This is a view shared by Lorna Blyth, managing director of investment proposition at Aegon, who says that UK pension funds have long sought global diversification in portfolios, stating that reintroducing a home bias in default arrangements "would be a bold move for trustees or group person pension providers".

"Any new incentives or requirements must be carefully considered, such as potential unintended consequences, long-term outlooks and the potential to further complicate pension scheme legislation, including tax implications," Blyth says.

"Incentives must align with fiduciary duties and consumer duty requirements," she adds. "Trustees generally oppose being forced to invest their scheme assets in a particular way if it is not in the members' best interests."

Fewer sticks

The government is clear that it wants UK pension schemes to invest in all UK assets including publicly listed equities. However, there is an undeniable emphasis on encouraging funds to make greater allocations to private assets, such as infrastructure, private equity and debt.

What is not clear however is whether Reeves supports the position of former chancellor Jeremy Hunt who proposed that pension funds be "encouraged to invest at least 5% of their assets in unlisted equity".

This is not a recommendation favoured by Justin Wray, interim head of defined benefit (DB), LGPS and investment at the Pensions & Lifetime Savings Association (PLSA), who says: "In terms of increasing UK investment, we strongly prefer incentives rather than mandating how much is invested. Requiring a proportion of assets to be invested in the UK would be sub-optimal."

Consternation about more draconian pension policy is also shown by Robert McInroy, head of LGPS client consulting at Hymans Robertson, who warns that should public pension schemes fail to support the government's position on UK investment "there is a potential for more interventionist policy".

"As a public sector pension scheme, the LGPS would likely be seen as 'low hanging fruit'. Options could include mandatory UK investment levels or enforced restructure, both of which would cause significant upheaval and potential unintended consequences," McInroy says.

More carrots

If the government is to have any hope of attracting UK pension schemes to invest on home turf, numerous reforms and incentives are needed.

Historically, DC schemes have been forced to focus on cost rather than value in their decision-making. The imposition of a fee cap for default investment strategies being a case in point.

The review asks whether a more consolidated LGPS and workplace DC market, combined with an increased focus on net investment returns rather than costs, would increase allocations to UK private markets.

Overall, commentators believe that prioritising value for money over cost would encourage DC investors to diversify into illiquid assets, and notes that such a framework is already under consultation with the Financial Conduct Authority.

Mark Jaffray, head of DC consulting at Hymans Robertson, says: "Private markets tend to have much higher management fees and their inclusion is likely to lead to higher ongoing charges for DC schemes and members. Assuming investment in high quality private market managers and assets, the addition of these investments to a DC portfolio could improve the net of fees returns and improve diversification which could reduce overall volatility."

However, Now Pensions' Holliday says that "competitive tenders are being won or lost on small fee differentials", and she would like the government to be bolder in the value for money proposals.

"For example, introducing an additional forward-looking return metric, otherwise the increased cost is emphasised over the anticipated greater net of cost returns of private market investments which may take some time to show through. We would also like to see clarification on how these increased costs could impact on the risk of becoming an 'amber-rated' scheme, especially before returns are realised."

There are additional caveats raised by Yona Chesner, head of investment in the North at consultancy Cartwright, who says:

Trustees generally oppose being forced to invest their scheme assets in a particular way if it is not in the members' best interests.

Lorna Blyth, Aegon

"Moving towards a more returns-driven approach can help solve the issue, however that comes with some risks.

"Key among these is overpaying for artificially complex solutions that don't drive additional value," he adds. "To mitigate this, we believe that ensuring appropriate levels of governance and independence of advice is a vital part of broadening out the opportunity set."

Unintended consequences

Alongside turning attention from cost to returns, the government has other options to incentivise pension schemes to invest domestically.

First is a lighter tax treatment for pension schemes investing in UK assets.

However, Aegon's Blyth says this would likely come with a stipulation that a certain percentage of assets be invested in a particular asset class, such as UK equities, listed and unlisted, which as noted is unpopular with the industry and "could backfire if the asset class underperforms".

The PLSA's Wray also recommends government provides policy and regulatory certainty to improve the UK's appeal versus investment opportunities globally. This includes developing a long-term strategy for investment and growth, outlining the government's priority investment sectors, its approach to blended finance and how it will work with the pensions industry.

In July, Reeves announced the £7.3bn National Wealth Fund (NWF), which she says does exactly this, by aligning the UK Infrastructure Bank and the British Business Bank to provide a single point through which pension schemes can invest in domestic assets.

Reeves said the government will bring forward new legislation when parliamentary time allows to cement the NWF in statute, making it a "permanent institution at the heart of the country's long-term growth and prosperity".

Hyman Robertson's McInroy says the government could consider LGPS-specific incentives for schemes that invest in the NWF, alongside other inducements including the removal of stamp duty, or ability to reclaim elements of tax, reducing the cost of UK investing and increasing returns.

"We acknowledge that incentives may cost money upfront but would underline the government's commitment to growth policies and, if successful, lead to higher tax revenues after incentivisation periods," McInroy says.

Essential investment

Whether schemes are encouraged or forced to invest domestically, the government is hugely reliant on the £830bn of assets held by private sector DC and public sector pension schemes if it is to stand any chance of driving growth and meeting its net zero by 2050 targets.

The Climate Change Committee says £50bn of investment is need every year between 2030 and 2050 to achieve a successful green transition.

Meanwhile, an EY report published in October estimates that the UK faces an infrastructure spending shortfall of at least £700bn by 2040. Closing this deficit without government spending would require private sector investment to more than double by 2040.

Philip Brown, director of policy and external affairs at the £40.6bn National Employment Savings Trust (Nest), says such funding gaps makes the UK an "excellent opportunity" for long-term investors who benefit not only from returns but from the improvements made in their home country.

A growing UK economy benefits our 13 million members and their pensions, so it's logical to explore our home market for private market assets.

Philip Brown, Nest

"With greater investment in private assets, the question becomes 'and why not in the UK?' A growing UK economy benefits our 13 million members and their pensions, so it's logical to explore our home market for private market assets.

"Our research shows that excellent UK investment opportunities exist across asset classes, particularly in property, corporate lending and infrastructure, and have specific UK-focused mandates in place to help us deploy money here," Brown says.

Nest already invests more than £8.5bn in the UK, a significant portion of which is through illiquid assets.

Brown says the trust "only expects our UK allocation to increase over the coming years" and Nest will continue to explore new opportunities, where it can "achieve the twin objectives of finding great investment opportunities and supporting UK economic growth".

However, he adds it is the government's responsibility to provide a continuous pipeline of investment opportunities so that Nest can maintain an asset allocation.

Joined-up thinking

Politicians are often accused of treating the UK pension system as a political football, and commentators are keen to see that the latest round of potential reforms improve the regime rather than complicate it further.

Holliday says the push for scale and consolidation under the first phase of the review has "significant pensions-market altering implications with consequential impacts for members".

She adds: "We would like an open discussion with government about its specific ambition for the size and shape of the market, and the relevant mechanisms, regarding this aspect of its policy interventions."

Members interests must be "front and centre", Holliday continues, pointing out that since not all schemes are alike – not all are open for all employers, and a large proportion of auto-enrolment savers and smaller employers are served by a small number of large schemes – "it is essential to have assessments of how policy proposals are impacting the different and specific segments of the market".

Brown agrees that members' interest must be paramount in any investment consideration, but believes financial factors "can, and often should, include broader economic considerations, such as climate change, improvements to UK infrastructure, and support for successful British companies that employ and provide services to UK workers".

The government will be under pressure to push through reform and shore up capital as quickly as possible to plug funding gaps. Yet rushing policy decisions could prove counterproductive. Working closely with those on the pension frontline and listening to the industry will be essential if the government is to achieve its 'new era for economic growth'.

THE FINAL COUNTDOWN

The record proceeds raised through the green bond market during the first half of the year. Europe led the way collecting $291bn – a 13% rise in 12 months.

Source: MainStreet Partners

$356bn

92%

The fall in IPO proceeds raised in Europe during the third quarter. Eight deals generated €300m, down from €3.3bn in the same period a year earlier. Elections in the UK, France and EU are to blame as corporates adopt a wait-and-see stance.

Source: PwC

76%

The institutional investors across Europe, the Middle East and Africa who expect their risk appetite for private assets to grow in the next two years, with 44% looking to increase their exposure to private credit.

Source: PGIM

£2.8bn

The combined pension payments the BT Pension Scheme makes to 212,000 retirees each year.

Source: Brightwell

80%

Most professional investors in Europe are indifferent to the active versus passive debate when it comes to selecting ETFs. They just want the best product.

Source: Ark Invest Europe

47%

The trustees, consultants and lawyers who believe the bulk annuity market could be worth between £50bn to £60bn next year. This is slightly ahead of the 45% who put the figure at £40bn to £50bn.

Source: Pension Insurance Corporation

91%

The insurers globally who intend to increase their exposure to private markets within the next two years, with 60% targeting clean energy infrastructure.

Source: Blackrock

$2,789

At the end of October, the price of gold hit another record high as geopolitical tensions continued to rise.

Source: DHF Capital

20%

The asset owners and their investment managers who believe impact investing could account for 15% of UK assets under management by 2030, up from 1% today.

Source: Pensions for Purpose

Quote of the Month

"The superpower of private markets is not risk mitigation; it is positive sustainable action."

Jo Waldron, M&G Investments