

MACFARLANES

Investor Intelligence report

UK pension schemes

Opportunities for private capital across
defined benefit and defined contribution

Introduction

With an estimated market size of approximately £4tr, the UK pension market is the largest in Europe and second largest in the world after the US. The market is evolving in a number of ways as multiple consultations and policy changes have been proposed across defined benefit (DB) and defined contribution (DC) schemes.

Overall, three broad themes can be identified:

1. consolidation/scale;
2. increasing investments in private assets; and
3. increasing investments in the UK.

Pensions have been a priority on the political agenda with both the Conservative and Labour parties agreeing that pension assets should be better utilised to grow the UK's economy, a topic our public policy team explored in a [recent article on privatecapitalsolutions.com](#).

Given this shared agenda, the incoming government should be able to build on the work already undertaken by the outgoing administration, such as previous consultations. Officials have long been focused on this area and will have refined their policy advice both in light of the direction of travel set out by Jeremy Hunt – the previous Chancellor of the Exchequer – and the similar approach taken by Rachel Reeves, the new Chancellor, in opposition. The Pension Schemes Bill, announced during the King's Speech in July, further indicates that a change of government will not disrupt policy development in this area, as the measures proposed mostly echoed those of the previous administration.

In this report we intend to take stock of the ongoing reforms and their impact on each sub-sector of UK occupational pensions and the opportunities and challenges they may pose for private capital.

Contents

Understanding the different segments of the UK pension market

The occupational pension market in the UK can be divided into defined benefit (DB) and defined contribution (DC). In DB schemes the employer bears the risk that investment returns on contributions made may not be sufficient to cover the defined-benefit the employee is entitled to receive at retirement. In DC schemes it is the employee that bears all investment risk. DB schemes can be divided into private and public sector. For DC, the relevant division is whether they are trust-based or contract-based. Personal pensions are included in Figure 1 on the following page for completeness but are out of scope for this report.

Public DB schemes

Within the UK public sector, the vast majority of pensions plans operate as pay-as-you-go, i.e. unfunded. This means that these plans do not have “funds” or pools of assets, instead pensions paid to current pensioners are directly financed from contributions paid by current workers. This includes pension funds for the Armed Forces, Civil Service, NHS, Teachers, Police and Firefighters with combined liabilities of over £1.2tr. This is a common model across Europe, however, in some countries, such as the US, it is more common for public occupational DB schemes to be funded – for example CalSTRS, Texas Teachers or the NYC Police pension.

This is a key enabler for the US's investment in private assets. In the UK however, local government pension schemes (LGPSs) are the only public service schemes which have investment funds and currently manage c.£425bn. England and Wales alone have 86 local authority schemes which are in the process of being pooled together into eight pools.








Private DB schemes

The private sector consists of pensions set up by private companies for their employees. Although this is still a large segment, with over five thousand schemes in the UK with approximately £1.4tr in assets under management, it is on a declining trajectory as the majority of these schemes are now closed as the UK is broadly abandoning private DB schemes in benefit of DC.

DC schemes

Occupational DC schemes include both trust-based and contract-based schemes each representing about half of the market – in 2022 the Investment Association estimated £270bn in trust-based and £275bn in contract-based pensions¹. Unsurprisingly, this is the fastest growing pension segment in the UK with assets predicted to grow to £800bn by 2030² across the trust and contract-based market. Trust-based schemes are regulated by the Pension Regulator whilst contract-based are regulated by the FCA. Although pension reforms so far have often referred to “trustees” and “trust-based schemes”, the FCA tends to also follow the same changes and ensures alignment across DC schemes.

Figure 1: UK pension fund landscape

Type	Regulated by	Pension type	Size	Trajectory	Description
Defined benefit (DB)					
Private sector	Pensions regulator	Occupational	£1.4tr		<ul style="list-style-type: none"> A pension fund set up by a private corporation for the benefit of its employees e.g. M&S pension scheme.
Public sector	Funded	DLUHC/ Pensions regulator	£425bn		<ul style="list-style-type: none"> Includes the Local Government Pension Schemes of England & Wales, Scotland and Northern Ireland.
	PAYG¹	Multiple	£1.2tr		<ul style="list-style-type: none"> Includes pension funds for the Armed Forces, Civil Service, NHS, Teachers, Police and Firefighters.
Defined contribution (DC)					
Trust-based pension schemes	Single trust	Pensions regulator	£100bn ²		<ul style="list-style-type: none"> A pension scheme that is established by a pension provider under a trust deed.
	Master trust	Pensions regulator	£170bn ²		<ul style="list-style-type: none"> Master Trusts are used to manage DC funds for a group of unrelated employers under a single trust (these can be offered by insurers acting as trustees).
Contract-based schemes	FCA	Occupational	£275bn		<ul style="list-style-type: none"> Under these arrangements there is a contract between the provider and the member but the employer is not a party to the contract and there are no trustees.
		Personal pensions	£790bn		<ul style="list-style-type: none"> Pensions arranged by individuals. This includes SIPPs, which hold over £205bn of pension assets and offer wider investment choice.

Notes: ¹PAYG (pay-as-you-go) pensions are unfunded meaning that assets are not set aside and invested, instead contributions are directly used to pay benefits. This figure represents their liabilities; ²According to the Investment Association the total AUM for trust-based pension is £270bn, £170bn can be attributed to Master Trusts according to Go Pensions. Sources: UK Parliament PLSA; Investment Association; Go Pensions.

Public DB schemes overview

The LGPSs have been a key focus for pension reforms as they are the largest public defined benefit schemes that are funded i.e. have pools of capital to invest. They were seen by the previous Conservative government as a key source of capital to “fuel UK companies”, a view that is likely to be continued, and even furthered, by the current Labour government.

In the 2024 Labour manifesto³, the Labour party stated that it would “increase investment from pensions funds in UK markets” focusing on “consolidation and scale, to deliver better returns for UK savers and greater productive investment for UK PLC”. In July 2024, the Chancellor, Rachel Reeves, renewed the focus on leveraging pension funds to fuel growth in the UK. As per the Treasury’s statement, “action will be taken to unleash the full investment might of the £360bn⁴ Local Government Pension Scheme to make it an engine for UK growth⁵.”

A key point for the LGPSs is that their fiduciary duties must ultimately guide their investments above the suggestions made by government. Although so far there have been no mandatory impositions on investments, there is increased tension as the government has been looking for ways to move forward its agenda without overstepping its position. According to the Pensions and Lifetime Savings Association (PLSA), a positive outcome could be achieved through fiscal benefits for pension funds that invest in alignment with the government’s proposals.

Key opportunities for private capital managers are driven by:

1. Establishing relationships with growing LGPS pools.
2. Government suggesting further investment in private equity.
3. Aligning products to levelling up goals, which are being promoted by government.

Note: “Levelling up” is a political policy introduced by the Conservative party which broadly aims at reducing economic inequality between different areas and social groups in the UK. With a Labour government this mission remains relevant, however, under a new name/policy. In March 2024, the Labour party published its plan to “Power Up Britain” which seems to replace levelling up.

1. Establishing relationships with growing LGPS pools

Pooling requirements were first introduced in 2015 and assets started to be moved into investment pools from 2018. For the LGPSs in England and Wales, with assets of £364bn⁶ there are currently eight pools but progress has been varied and on average⁷ c.60% of assets remain outside the pools’ ownership. To accelerate the transition, in November 2023 a deadline was set for the transition of all liquid assets to the pools by March 2025.

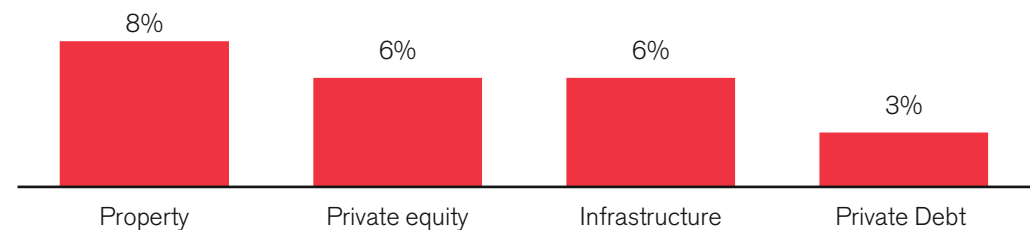
This creates opportunities for managers as pools are allowing some of the local authorities that previously did not have the scale/resources to invest in alternatives to do so. However, it also poses challenges as new relationships must be built. Each individual LGPS still sets its strategic asset allocation, but manager selection primarily sits with the pools. Managers that mainly maintain direct relationships with individual LGPSs may look to expand these.

2. Government suggesting further investment in private equity

It was suggested that LGPSs should invest 10% of their portfolio in private equity (not mandatory). The focus on private equity and omission of private debt has been criticised by the PLSA which believes that the focus should be on “private capital”, a sentiment that has been publicly shared by several LGPSs. The government’s response was that although the target is for private equity, it recognises and hopes to incentivise broader opportunities in private markets.

When considering the target of 10% for private equity, several funds fall short with average allocations of 6% according to the latest numbers provided by the LGPS Board for England & Wales⁸. When considering “private capital” in its broader sense which includes private equity and venture, private debt and most of infrastructure and real estate, for several LGPS, the 10% target has already been achieved.

Figure 2: England and Wales LGPS aggregated asset allocation



Source: England and Wales LGPS annual report, 2023.

A clear signal is being sent that public DB schemes are expected to increase allocations to private assets, particularly equity. This market represents an area of opportunity for private capital not just due to its role in the political agenda, but due to the growth of LGPSs pools, which also requires them to create more private market mandates. Several pools are actively expanding their private markets offering, for example:

- **London CIV:** launched in 2021 its first private debt fund, a closed-ended structure with two managers: Churchill Asset Management and Pemberton Asset Management. The LGPS pooling company is currently in the process of launching LCIV Private Debt Fund II. The proposed fund structure will be an open-ended evergreen multi-manager structure with higher manager diversification.
- **ACCESS:** this pool has been pushing into private markets in the past year. In 2023 it announced mandates for infrastructure and real estate and in 2024 two additional mandates for private equity.
- **Border to Coast Pensions Partnership:** the pension pool launched in April 2024 its "UK Opportunities" portfolio. According to With Intelligence, this will include three sleeves: 1) private equity and private credit; 2) infrastructure and 3) real estate. The pool is expected to commit to four funds per sleeve.

3. Aligning products to levelling up/power up goals

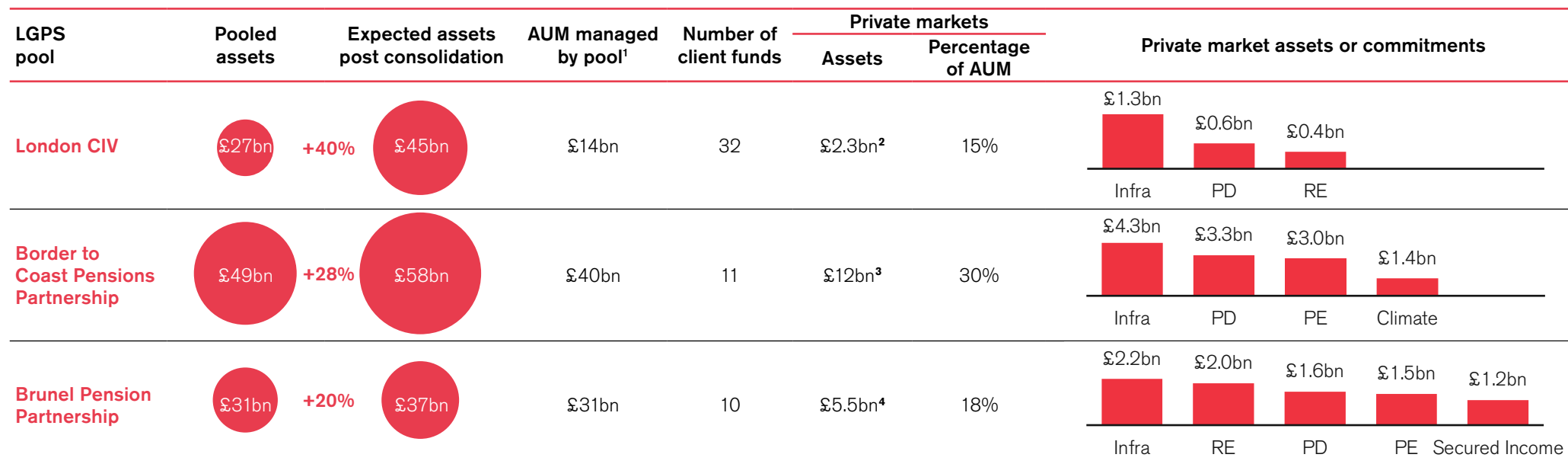
The previous government had proposed a requirement for LGPSs to publish a plan to invest up to 5% of assets to support levelling up in the UK. Continuity is expected under the new Labour government with the new "Power Up Britain" plan. Funds would have to report on their current level of "levelling up" investments and a plan to reach 5%. Although reporting would be mandatory, the 5% target is only a target, i.e. it is not mandatory. Exact figures on levelling up alignment are not yet available, but it is estimated that only a minority currently meets this target.

An investment meets the levelling up requirement if:

- It contributes to one of the 12 levelling up missions – living standards, research and development, transport, digital connectivity, education, skills, health, well-being, pride in place, housing, crime and local leadership.
- It supports any local area within the UK.

It has been acknowledged that levelling up is not an asset class, and different types of investment could support the goals of levelling up. Private capital managers that deploy capital in the UK may position their products to be compatible with levelling up/power up goals. This may not require new product design, but rather a mapping exercise that evidences a portion of alignment.

Figure 3: Examples of LGPS pools' commitments to private markets



Notes: ¹Excludes passive funds pooled with other managers e.g. London CIV has £12.5bn pooled with BlackRock and LGIM in passive funds; ²Does not include The London Fund, a £195mn partnership with LLPI investing in real estate an infrastructure; ³Currently preparing to launch a real estate proposition as part of the pool; ⁴Deployed capital, does not include a further £3bn in commitments which are shown in the next column. Sources: 2023 annual reports.

Private DB schemes overview

Currently only 4% of private DB schemes are open to new members⁹. The decline of private DB schemes has had a negative impact on investment in private capital.

This is a trend seen also in other countries, such as the US, that are also transitioning private sector pensions to DC schemes. Interestingly, although DB assets make up a smaller percentage of the total US pension market when compared to the UK, the opposite is true for the proportion of private DB schemes still open to new members.

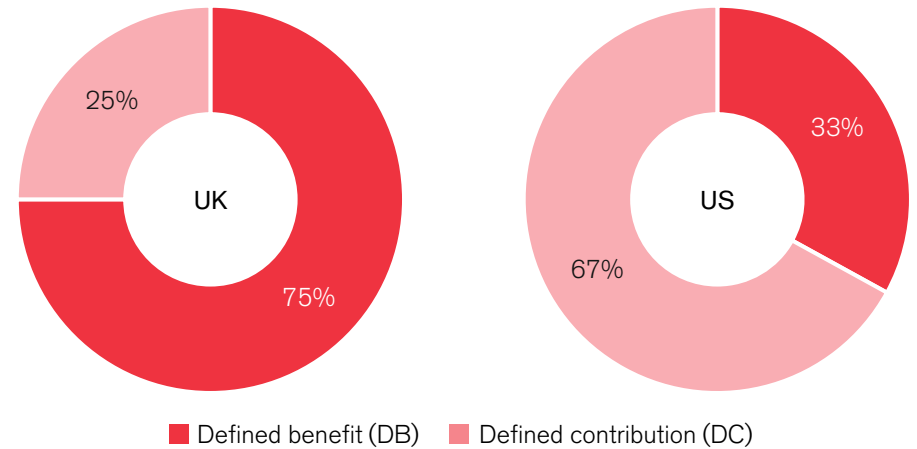
Most UK DB schemes are now closed for new members and have essentially three endgame options:

- **Insurance solutions:** most often these solutions involve a buy-in and/or buy-out¹⁰, meaning the scheme trustees use the pension scheme's assets to purchase an insurance policy thus transferring pension liabilities to the insurance company, effectively de-risking its position. This can happen in stages where the insurer assumes only a portion of the scheme's liabilities at a time.
- **Consolidation:** transferring liabilities to a consolidator, either a DB master trust or a superfund. When transferring to a DB master trust the link to the sponsoring employer is not broken, the employer benefits from being part of a larger scheme, but it remains responsible for the liabilities. Superfunds on the other hand, do remove the scheme from the sponsoring employer's balance sheet.
- **Self-sufficient run-off:** the schemes follows its natural course independently managing its own liabilities until all benefits are paid off.

Key opportunities for private capital managers are driven by:

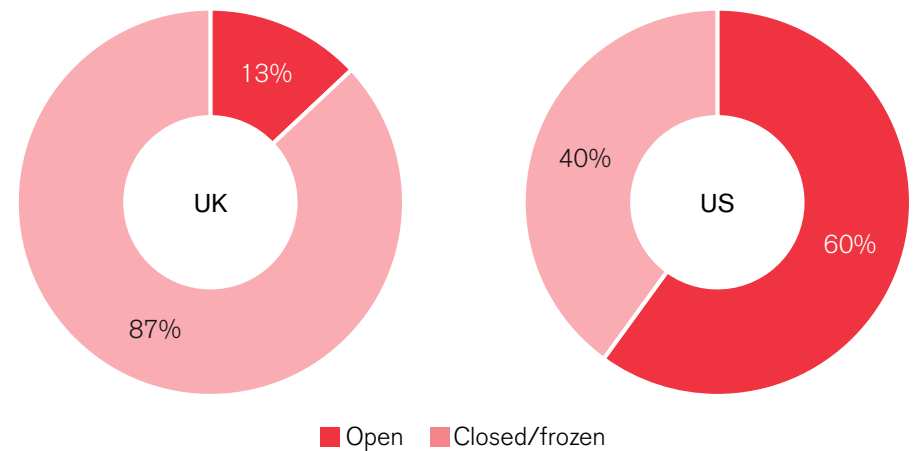
1. Insurance buy-outs creating a growth in secondary transactions.
2. Insurers' increased exposure to illiquid assets driven by buy-outs and Solvency reform.
3. Growth of Superfunds and their investments in illiquid assets.
4. Proposed reforms on surplus sharing to promote investment in productive assets.

Figure 4: DB/DC split of pension assets



Source: Thinking Ahead Institute, 2024.

Figure 5: Percentage of members in open vs. closed private DB schemes



Source: The Pensions Regulator, 2024.

1. Insurance buy-outs creating a growth in secondary transactions

Insurance solutions are a popular endgame option. This is a high-growth market with 2024 figures expected to double in size from 2022. According to abrdn¹¹, projections for the next decade suggest further transfers of over £500bn.

This is in part driven by the rise of interest rates. Interest rates are used to calculate the present value of future pension liabilities. When rates go up pensions liabilities go down and funding levels improve. On aggregate, private DB schemes in the UK have become overfunded making it easier for corporates to offload their pension liabilities to insurers.

Currently 53% of large UK DB schemes are targeting a buy-in/buy-out¹². Not only are more schemes looking for buy-outs, the speed at which these transactions are taking place is increasing. As more pension assets are being moved to insurers this creates challenges and opportunities as life insurers' asset allocations are impacted by regulations which restrict private capital investments.

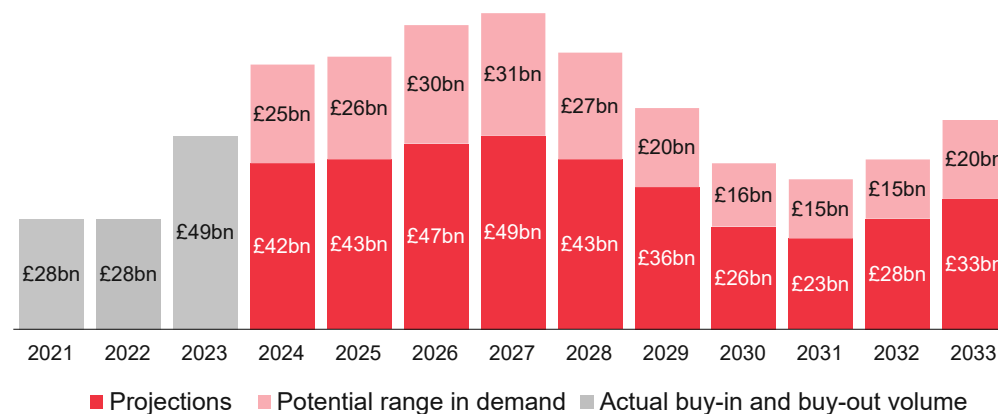
Insurers make investment decisions that optimise for Solvency requirements, which for insurers managing annuities includes eligibility for a regulatory treatment known as the “matching adjustment”. Ensuring that both insurance liabilities and assets held to back those liabilities qualify for this treatment enables the insurer, for example, to price transactions such as pension scheme buy-ins/outs at an affordable level, which has been crucial to the growth of this market. At a high-level, to be eligible for matching adjustment, assets must consist of bonds and other assets with similar cashflow characteristics, cashflows must be fixed¹³ and immutable by the issuer or third-parties, assets must replicate the obligations' cash flows in the same currency and must be maintained over the lifetime of the obligations to which they are matched.

Due to these regulations, before going through a buy-in/buy-out, pensions schemes have typically looked to reduce their illiquid positions, either by letting them run off or by selling them in secondary transactions¹⁴.

Matching adjustment: The “matching adjustment” allows insurers to discount the valuation of their long-term liabilities (life insurance obligations, including annuities) under Solvency II at a more favourable discount rate than the usual risk-free rate (where certain eligibility criteria are met), thereby reducing the assets required to be held against those liabilities. This mechanism adjusts for the fact that where life insurers' liabilities are long-dated, assets that match these liabilities are not intended to be sold.

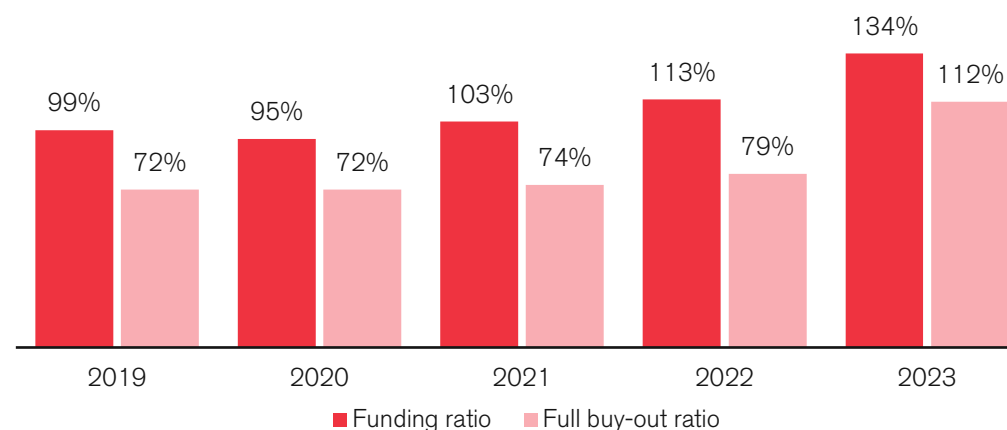
Third-party secondary transactions may be the preferred solution when dealing with assets that do not fit matching adjustment eligibility¹⁵. Some schemes may prefer the insurer to take on the illiquid positions and, although this may be possible, it could result in having to accept a significant haircut on valuation and potential delays in the transaction due to the insurer's due diligence process.

Figure 6: UK pension buy-ins/buy-outs annual volumes and projections



Source: LCP, 2024.

Figure 7: UK private DB schemes – aggregate funding ratios



Source: The Pensions Regulator Purple Book for 2023.

Note: A pension scheme's buy-out funding ratio will often show a larger shortfall than the standard actuarial valuation, as insurers are obliged to take a very cautious view of the future, and they also seek to make a profit.

We anticipate a growth in LP-led secondary transactions driven by a growth in the insurance buy-out market and by the large number of pensions funds currently looking for insurance solutions with significant portfolios of illiquid investments. This is still due to the LDI crisis of 2022¹⁶ and the speed at which schemes are currently looking to be bought-out. Consequently, we will continue to see an increase in secondary transactions.

Note: According to Standard Life, 40% of schemes approaching the market have illiquid assets to manage and sometimes this portion is as large as 50%.

For secondaries managers this presents a significant opportunity as the high demand from pension schemes is expected to lead to portfolios of assets coming to market at attractive prices. The opportunity in this market has also led investment consultants to launch platforms to assist their pension clients navigate secondaries.

Sellers and buyers

- **The Tesco Pension Fund:** in February 2023 Tesco Pension Fund entered a £1bn secondaries deal to sell a portfolio of private equity, private credit and infrastructure. The sale was part of Tesco's long-term de-risking strategy. The portfolio was acquired by six buyers, according to Buyouts Insider.¹⁷
- **Cummins Pension UK:** in September 2023, it was announced that ICG LP Secondaries acquired a \$200mn portfolio of buyout GP positions from the pension fund. According to Secondaries Investor¹⁸, the transaction saw a discount to net asset value in the high teens.
- **Border to Coast Pensions Partnership:** it was reported in March 2024¹⁹ that this LGPS pool is looking for bargains in the secondary market as DB schemes sell their portfolios at discounts. The pool has been most active in private equity secondaries but is also considering opportunities in private credit and infrastructure.
- **Pension Protection Fund:** the fund has also benefitted from attractive secondary transactions having purchased a property fund at a 35% discount to net assets from another pension fund this year.

Platforms

- **ISIO's Fund Liquidity Options, launched in 2024:** this is a platform created to help clients sell private credit and infrastructure equity holdings on the secondary market.
- **WTW's Illiquid Asset and Buyout Specialist Group, launched in 2023:** the new group offers advice on managing illiquid assets in the run-up to buy-out including sales on the secondary market. In a press release²⁰, the Head of this group said they had seen "a 50% increase in first time sellers on the private equity secondary markets in the last year".

2. Insurers' increased exposure to illiquid assets

Since Brexit, the PRA has been working on the UK version of Solvency II (Solvency UK) which includes reforms to the matching adjustment rules. One of the key objectives, as stated by the Treasury, is to lead to more insurance investment in infrastructure, and other illiquid assets to support the UK economy. This is very much in alignment with the narrative for pension assets where the current government also wants to increase investments in private assets.

Note: Given the recent election, it should be noted that the Labour party has shown great support for the Solvency II reform. The previous Shadow Economic Secretary to the Treasury, Tulip Siddiq, said at an Association of British Insurers (ABI) conference earlier this year that a future Labour government would go beyond regulatory reform and "smash down the blockers to investments".

The new rules²¹ allow for 10% of the matching adjustment benefit to be attributable to highly predictable cashflows (rather than fixed cashflows) and make sub-investment grade assets efficient from a matching adjustment perspective by removing what has been known as the "BBB cliff"²². Additionally, the PRA will look to streamline the matching adjustment application process for certain assets.

These reforms to Solvency II, in addition to the need to deal with illiquid assets to enable pension buy-outs, are both drivers for insurance companies to increase their exposure to illiquid assets. Our view is that this can create opportunities for private debt managers that are able to design products where cashflows are structured in a way that is consistent with the requirements for matching adjustment. Some of the adaptations that can make private loans eligible for matching adjustment include make-whole loan clauses, structuring solutions to mitigate the prepayment risk, fixing interest payments or using derivatives to convert interest payments from floating to fixed. Alignment to matching adjustment has typically been easier to achieve within infrastructure debt and real estate debt as these loans produce stable cashflows and more readily lend themselves to longer-term funding.

To take advantage of these opportunities, managers should build/strengthen relationships with insurers as these will increasingly be the institutions holding pension assets. Figure 8 on the next page shows the list of insurers that are currently active in the UK pension buyout market. We can see high levels of growth and market concentration as well as the presence of new market entrants.

Figure 8: Insurers participating in the UK buy-in/buy-out market

Insurers ¹	Buy-out volume in 2023 ¹	Market share in 2023	Volume growth since 2021	Largest single transaction ¹
Rothesay	£12.7bn	50% market share	↗ x4	▪ Telent: £4.7bn, 2019.
Legal & General	£12bn		↗ x2	▪ Rolls Royce: £4.6bn, 2019.
PIC	£6.9bn	50% market share	↗ x2	▪ RSA: £6.5bn, 2023.
Standard Life/ Phoenix	£6.2bn		↗ x1.2	▪ Imperial Tobacco: £1.8bn, 2022.
Aviva	£5.5bn		↘ x0.9	▪ Aviva Pension Scheme: £1.7bn, 2022.
Just	£3.4bn		↗ x1.8	▪ GKN: £0.5bn, 2023.
Scottish Widows	£0.9bn		↗ x9	▪ Exited the market in 2024 , the bulk annuity platform was acquired by Rothesay.
Canada Life	£0.6bn		↘ x0.6	▪ Undisclosed: £0.9bn.
M&G	£0.6bn		1%	Re-entered in 2023
Royal London	£0.3bn	1%	New market entrant in 2024	▪ Royal Liver: £0.3bn, 2024.

Notes: ¹According to LCP as of October 2023. Only buy-ins and buy-outs with a UK pension scheme are included.
Sources: Lane Clark & Peacock LLP (LCP).

Note: In July 2024, Brookfield applied for an insurance license with the PRA to enter the UK corporate pension buy-out market. Brookfield has owned Oaktree since 2019, an alternative-asset manager with over \$170bn in assets under management. Coincidentally, Utmost, a British insurer backed by Oaktree, is also expected to enter the buy-out market in 2024. This increased competition can be a driver for innovation for insurers and asset managers.

3. Growth of Superfunds and their investments in illiquid assets

As an alternative to insurance buy-outs, pension schemes may look to transfer their assets and liabilities into a new DB pension scheme, i.e. Superfund, which is backed by additional capital from external investors. This risk-transfer solution is seen as a lower cost solution for pension schemes which is meant to be used only by schemes that cannot access the insurance market in the foreseeable future (Pensions Regulator's guidance suggests this is up to five years).

This is still a recent concept in the UK. The Pensions Regulator created an interim regulatory regime in 2020 and it is currently developing a permanent legislative regime²³ which may lead to more Superfunds being established. The King's Speech in July 2024 confirmed that consolidation through Superfunds remains on the agenda for the current administration.

As the Superfund market develops this may provide an opportunity for private capital as Superfunds are expected to benefit from scale when compared to individual schemes and they operate outside the insurance regulatory framework which puts them at a more favourable position than insurance companies.

The previous government had also consulted on establishing a public sector consolidator operated by the Pension Protection Fund (PPF) by 2026²⁴ which would target DB schemes that are unattractive to commercial consolidation providers. According to the consultation, one of the aims of the PPF Superfund is to enable greater investment in "high-growth UK assets" than would have been achievable without the consolidator, which again aligns to the broader objectives across pensions – consolidation, investing in private assets and investing in the UK.

Note: Some Superfunds will hold the assets and liabilities until run-off whilst others act as an interim solution whereby they look to sell to an insurer once an improved funding ratio has been achieved. The latter is the model used by Clara Pensions, which is so far the only Superfund to be approved by TPR and is backed by Sixth Street.

4. Surplus sharing to promote productive assets

Defined benefit pension schemes are typically not incentivised to maximise returns, but rather to match assets and liabilities. Well-funded schemes for example tend to shift their investment strategy to capital preservation rather than growth. This has largely been driven by the funding regime that pension schemes have to comply with. The fact that it is often difficult for sponsoring employers to access any surplus in a pension scheme also has an impact on funding and investment decisions.

The previous government was looking to reform the treatment of scheme surplus for private defined benefit schemes by making it easier to share scheme surplus with employers and scheme members. One of the key aims stated was to support schemes to invest in more "productive assets"²⁵, a goal which aligns with the Labour party's manifesto. The consultation closed in April 2024, a response from the Department of Work & Pensions was expected later this year, but this may be impacted by the change of government.

DC schemes overview

Last year a series of reforms for DC trust-based schemes were proposed which are meant to significantly unlock capital for the private capital industry - £50bn by 2030 according to the Mansion House speech²⁶. The current Chancellor has echoed the aims of the previous administration and announced that a pensions review will “explore ways to increase their investment into productive assets” as “even a one percentage point shift of assets into productive investments could mean £8bn of new productive investment to grow the economy and build vital infrastructure by the end of the decade.²⁷”

An analysis of some of the largest master trusts in the UK reveals that so far, most have no allocations to private equity or private debt, but several have expressed intentions to change this (see Figure 10 on the following page). Allocation to other alternative asset classes such as infrastructure and real estate exist, but exposure is achieved often through more liquid products.

Key opportunities for private capital managers are driven by:

1. The Government's agenda to drive further investment in unlisted equities through the Mansion House Compact.
2. The introduction of several additional reporting obligations and other reforms that are expected to encourage DC trustees to invest in private markets.

Figure 9: Mansion House signatories

Mansion House signatories	AUM ¹	Market share of master trusts ²	
M&G/Prudential	£120bn		-
Nest	£37bn		22.0%
Legal & General	£25bn		15.0%
Aviva	£10bn		6.0%
Standard Life/Phoenix	£9bn		5.0%
Mercer	£7bn		4.0%
Aon	£6bn		3.0%
Smart	£5bn		3.0%
Aegon	£4bn		2.5%
Scottish Widows	£3bn		1.5%
Cushon	£2bn		1.3%

Notes: ¹This AUM refers to the Master Trust except for M&G/Prudential which is not a master trust, where the AUM refers to the 'With-Profits' fund; ²According to Go Pensions DC Master Trust League Table 2024, H1. Represents the market share of commercial master trusts, this includes data from 19 master trusts representing c. £170bn AUM.

Figure 10: Analysis of the Mansion House signatories

These are the six largest commercial master trust DC schemes that signed the Compact, and their outlooks into private markets. Allocations refer to the default fund.

Manion House	Master trust AUM	Real assets	PE/PD	Investment adviser ¹	Expressed targets and comments
Nest	£37bn	13%	4% - PC 2% - PE ²	In-house	<ul style="list-style-type: none"> Manage £5bn in property, private credit, unlisted infrastructure and private equity. Private markets are c.15% of total portfolio, 45% of private assets allocated in UK. <p><i>"We continue to diversify into private assets such as property and private equity. These assets can produce long-term, strong growth."</i> CIO, Nest. IPE, 2023</p>
Legal & General	£25bn	10% ³	0%	Hymans Robertson	<ul style="list-style-type: none"> In July 2024, L&G launched its Private Market Access Fund expected to unlock private market access for 5.2m DC members – available for DC schemes to invest in directly and via the new "L&G Lifetime Advantage Fund" default strategies. This product is a Fund of Funds with underlying investment in L&G's LTAF which the FCA had approved earlier in May. <p><i>"The fund is a one-stop-shop for private market exposure and we hope it will inspire DC members into greater engagement with their pension."</i> Head of DC, Legal & General. Press release, 2024</p>
Aviva	£10bn	10% ⁴	0%	Isio	<ul style="list-style-type: none"> Aviva's Head of Real Assets has predicted that 90% DC schemes will allocate 10% to illiquids. Prefer simpler/more transparent fee structures for private markets. Aviva has so far launched two LTAFs – Real Estate and Climate Transition Real Assets. <p><i>"We will shortly be allocating to further illiquid assets such as private debt and infrastructure, and over time, private equity such as venture capital."</i> Head of Investment Strategy, Aviva. Corporate Adviser, 2024</p>
Standard Life/ Phoenix	£9bn	6.2%	0%	Reddington	<ul style="list-style-type: none"> Phoenix Group and Schroders launched a new private markets investment manager, 'Future Growth Capital' (FGC) to promote the Mansion House objectives. Launching with £1bn in initial commitments, the FGC will aim to deploy £10-20bn of investor funds into private markets over the next decade. <p><i>"This facility will also play a significant role in the future design of our flagship defaults"</i> Group CEO, Phoenix Group. Schroders press release, 2024</p>
Mercer	£7bn	0%	0%	In-house	<p><i>"I can envisage some clients wanting a 10% private markets allocation straightaway, and that will be fine with us. And certainly by 2030 we would expect our private markets allocation to be larger than 5%."</i> Investment and Retirement Lead, Mercer. IPE, 2024</p>
Aon	£6bn	Yes, amount unknown	0%	In-house	<ul style="list-style-type: none"> Aon will first focus on building its private markets allocation, particularly private debt and infrastructure, and then over time will look to introduce private equity. Aon is currently appointing specialist managers for each area of private markets. It will be 12-18 months before allocation begins. <p><i>"It might include productive finance but not necessarily private equity. Private equity will follow once we've got potential vehicles. It will take some time to get up and working."</i> CIO, Aon. IPE, 2024</p>

Notes: ¹According to the Corporate Adviser Master Trust report 2024; ²As of September 2023, Based on Nest's 2040 Retirement Fund (default strategy); ³Based on growth phase of the fund, as of 30 April 2024; ⁴Allocation to property in 'My Future Focus – Aviva's default investment solution, as of April 2024. Sources: IPE, Top1000funds, Corporate Adviser, Corporate Adviser Pensions Average, companies' media releases.

1. Government's agenda to drive further investment in unlisted equities

Although currently not mandatory, the eleven Mansion House signatories have committed to invest 5% of their default funds into “unlisted equities”. These signatories represent approximately 60% of the UK's master trust assets.

Until now, the term “unlisted equities” has not been properly defined, but is thought to include investments in private equity and venture capital. So far, such investments have represented 0.5% of allocations on average.²⁸

2. Reporting obligations and other relevant reforms

In addition to Mansion House, several other reforms have been proposed that aim to positively impact DC schemes' ability or willingness to invest in private assets. These are summarised in the following table.

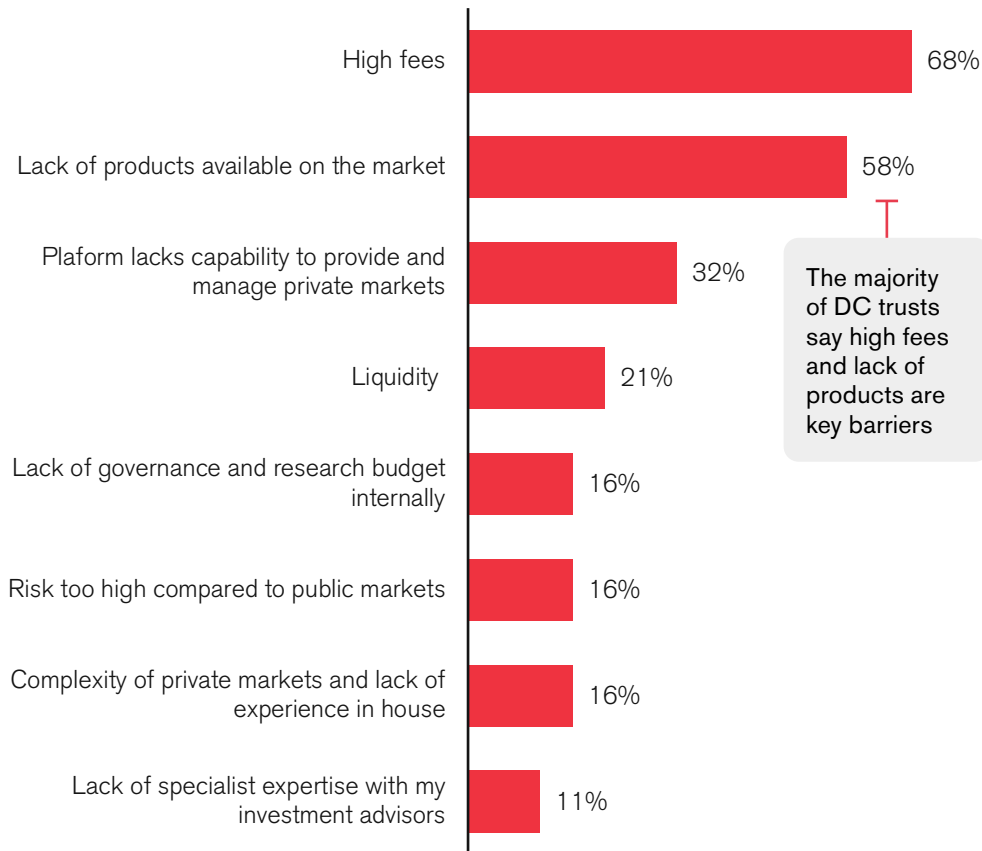
Figure 11: DC schemes reform proposals

Proposed reform	Status	Summary of reform	Impact
Changes to fee cap	Effective since April 2023	<ul style="list-style-type: none"> Performance fees were excluded from the 0.75% charge cap that applies to default arrangement in DC schemes. 	<ul style="list-style-type: none"> Potential increased ability to invest in alternative assets which typically charge higher fees. Managers have in theory more flexibility on how to structure compensation.
Investment policy for illiquid assets	Required by 2024	<ul style="list-style-type: none"> Trustees will have to state their policy on investing in illiquid assets for their scheme's default arrangements, disclose the asset breakdown, and provide a justification if they have not allocated to private markets. 	<ul style="list-style-type: none"> Sets expectation that DC schemes should consider investment into private assets.
UK investment disclosures	Required by 2027	<ul style="list-style-type: none"> DC schemes to publish breakdown of allocations, including UK equities, investment in British businesses and costs/returns. 	<ul style="list-style-type: none"> Currently there is no obligation for DC schemes to invest in the UK, but this reform will add pressure to do so.
Value for money framework	Announced in Spring 2024 Confirmed to be continued by the current government ²⁹	<ul style="list-style-type: none"> The reform shifts focus from cost to long-term value. DC schemes will have to compare their performance against at least two other schemes.³⁰ 	<ul style="list-style-type: none"> DC schemes are incentivised to allocate more to private markets as the focus is on returns and those performing poorly will not be able to take on new business or may be forced to merge.
Consolidation of deferred small pots	Consultation launched in Summer 2023 Confirmed to be continued by the current government ³¹	<ul style="list-style-type: none"> Trust-based DC schemes holding less than £1,000 would be automatically consolidated into “default consolidator(s)” which would likely be a limited number of approved master trusts. A “pot follows member” approach was also suggested but has been less popular as the frequency of transfers would increase liquidity needs working counter to the focus on productive finance. 	<ul style="list-style-type: none"> This would mean an increase in the number of transfers out of any schemes with many small pots thus leading to higher liquidity needs, which would be a barrier for illiquid assets. On the other hand, the aggregation of these small pots into consolidator schemes would allow them to increase scale quickly and could be positive for private asset investments.
Lifetime model	Call for evidence launched in Autumn 2023. Mentioned again in the Spring Budget. ³²	<ul style="list-style-type: none"> Savers to keep pensions with one provider even if changing employers creating a “pot for life” approach. The aim is to reduce small/dormant pots and to “support wider investment in high growth assets”. 	<ul style="list-style-type: none"> In the long-term this would lead to large, consolidated pots with significantly lower liquidity requirements, both of which could facilitate investment in private markets.

Still, key barriers remain, which explain the low levels of investment in private assets when comparing the UK to other countries with significant DC markets such as Australia or Chile. These are:

1. The charge cap that applies to default schemes and negative views on performance fees.
2. The use of unit-linked funds which constrain the products DC schemes can invest in to access illiquid assets.

Figure 12: What are the most significant barriers to investing in private markets for your DC trust?



Source: The Defined Contribution Investment Forum, 2024.

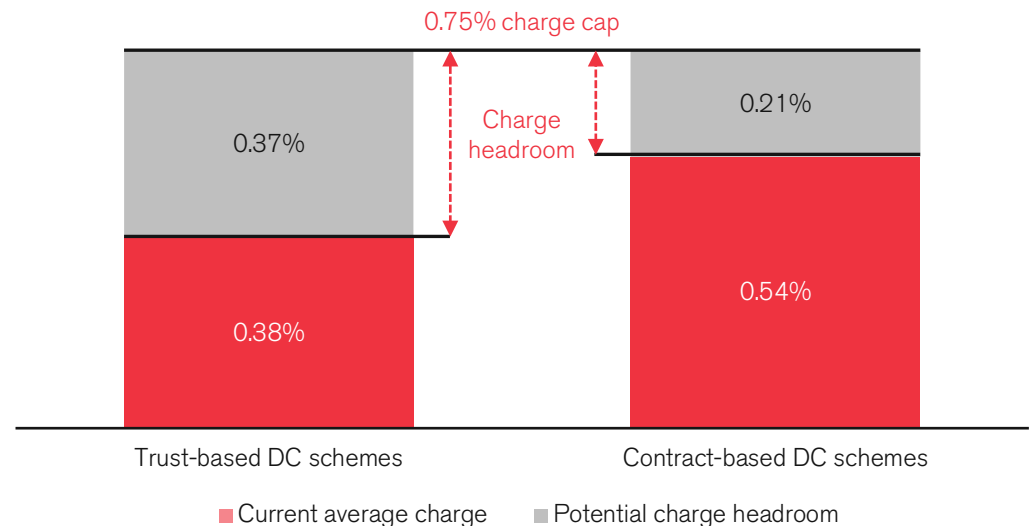
1. Charge cap and views on performance fees

Trustees and managers of occupational pension schemes which are used to meet employers' automatic enrolment duties must ensure that the costs and charges borne by the scheme do not exceed 0.75%. This is known as the "charge cap".

Although at first glance the charge cap might appear to be the main barrier for private capital investments where managers typically charge much higher fees:

- the charge cap applies on a "blended" basis across all the funds held within the scheme. This means that a private capital manager could charge fees in excess of 0.75% if there were other lower cost funds in the scheme, provided there is sufficient "headroom"; and
- given the historical focus on costs, many DC schemes have invested in low cost funds to date and are operating currently with aggregate fee levels below the 0.75% cap, so there could be room to include private capital funds in these schemes. This headroom is indicative of a broader mindset which favours lower fees over higher returns and is currently being addressed through the value for money framework. Similarly, the exclusion of performance fees from the charge cap, affords additional flexibility to fund managers on their charging structures, but it does not address the broader underlying issue – most DC schemes do not believe performance fees fit their models (see Figure 14 on the following page).

Figure 13: Average charges for qualifying schemes for automatic enrolment



Source: Department of Work and Pensions, 2021.

A common reason cited is that performance fees may make it difficult to ensure that fees are attributed fairly between members. Members will invest/divest at different times making it challenging to ensure that the members that are bearing the cost of the performance fees are also the ones benefiting from strong performance. In this context, a much greater emphasis is put on valuations and DC schemes must provide transparent and clear reporting on costs and charges to their members.

Opportunities exist for managers that are able to solve this problem. Some managers, particularly within infrastructure and private credit, have rejected carried interest completely in favour of a flat management fee model to attract DC investors. Others are considering performance fee models that more closely resemble hedge funds, perhaps using techniques such as series accounting or equalisation to address concerns around member fairness.

Figure 14: Do you agree with performance fees being allowed in DC schemes?



Source: Corporate Advisor Intelligence, Master Trust and GPP Defaults Report, 2024.

2. Investment through unit-linked funds

Many DC pensions schemes are managed by life insurance companies. These funds are then typically invested through unit-linked funds, which are products that have underlying pooled investments (fund-type structures) linked to an insurance policy. These products combine plan-holders' capital into a pooled fund which allots them units according to how much money they have invested. The popularity of unit-linked funds from a buyer perspective is that they can achieve highly diversified exposures at lower cost, from an insurer's perspective, they may also receive a more favourable treatment under Solvency II through unit matching. The rules that set out the types of assets that can be held in unit-linked insurance funds are commonly called "permitted links rules". These rules are meant to protect the retail investors, who ultimately bear the investment risks of these products, and have been a key barrier for private capital due to their restrictions on unlisted and illiquid assets – broadly, unlisted securities are permitted only if "readily realisable in the short term", which means that private capital investments are unlikely to qualify.

According to the FCA, most UK pension savers who are members of defined contribution pension schemes invest via unit-linked funds. When analysing the signatories to the Mansion House Compact, the relevance of permitted links rules becomes clear. Out of the nine, only one DC master trust has a completely in-house governance model whereby trustees choose managers for each asset class, not dependent on an insurer's investment platform. Master trusts managed by consultants, as in the case of Mercer and Aon, typically also invest through insurance platforms, which again engages the permitted links rules (see Figure 15 below).

Figure 15: Mansion House Master Trust Analysis

Mansion House Master Trust	AUM ¹	Market share ¹	Type	Insurance-linked	Trustee governance model for asset allocation ³	Investment platform ³
Nest	£37bn	22%	Independent	No ²	In-house	None
Legal & General	£25bn	15%	Insurer	Yes	Outsourced	LGIM
Aviva	£10bn	6%	Insurer	Yes	Outsourced	Aviva
Mercer	£7bn	4%	Consultant	Indirectly	Outsourced	Aviva / Scottish Widows
Aon	£6bn	3%	Consultant	Indirectly	Outsourced	Aegon
Smart	£5bn	3%	Independent	Indirectly	Hybrid	LGIM / Mobius Life
Aegon	£4bn	2.5%	Insurer	Yes	Outsourced	Aegon
Scottish Widows	£3bn	1.5%	Insurer	Yes	Outsourced	Scottish Widows
Cushon	£2bn	1.3%	Independent	Indirectly	-	Aegon / Mobius Life

Notes: ¹According to Go Pensions. Represents the market share of commercial master trusts, this includes data from 19 master trusts representing c. £170bn AUM; ²May invest in unit-linked products as part of a the broader asset allocation; ³According to DC Investment Forum.

As shown, permitted links rules are a significant hurdle to access a large addressable market. Luckily there have been several changes to these rules in the past three years to facilitate investments by DC schemes in more illiquid assets. The most significant change has been the creation of the Long-Term Asset Fund (LTAF) and its inclusion as one of the new “conditional permitted links”, meaning, it can be held in a unit-linked fund. The LTAF was first available in 2021, although there was limited uptake. However, in 2023 we saw a renewed interest, mainly explained by two factors:

- When LTAFs were first created they were only available to default arrangements in DC schemes.³³ In 2023, distribution was extended to mass market retail investors, as well as self-select DC pension schemes and Self-Invested Personal Pensions (SIPPs). [Read our article on this topic on macfarlanes.com](#). Although this report does not go into much detail on personal pensions, SIPPs represent a large and growing market, which alone holds more assets than the DC master trusts market.
- The previously mentioned reforms such as the Mansion House Compact and the obligation for DC scheme investment policies to refer to investment in illiquid assets, have increased pressure on DC schemes to invest in private assets.

LTAFs are the only UK authorised fund product supporting direct access to private asset classes and are expected to become the vehicle of choice for managers looking to access DC capital and more broadly “democratise” their offering for a UK investor base.

A broad range of asset classes are suited for LTAFs including private equity, private credit and real assets, however, given these are open-ended funds with typically regular redemption opportunities, private credit is particularly well positioned for this product and is where we currently see the highest demand, alongside diversified private capital strategies, often delivered through a fund of funds model.

Overall, it is important for managers to understand how to deliver access to alternative assets for different types of pension funds. Figure 17 below provides a high-level summary.

Figure 17: Delivering access to alternative assets for pension funds

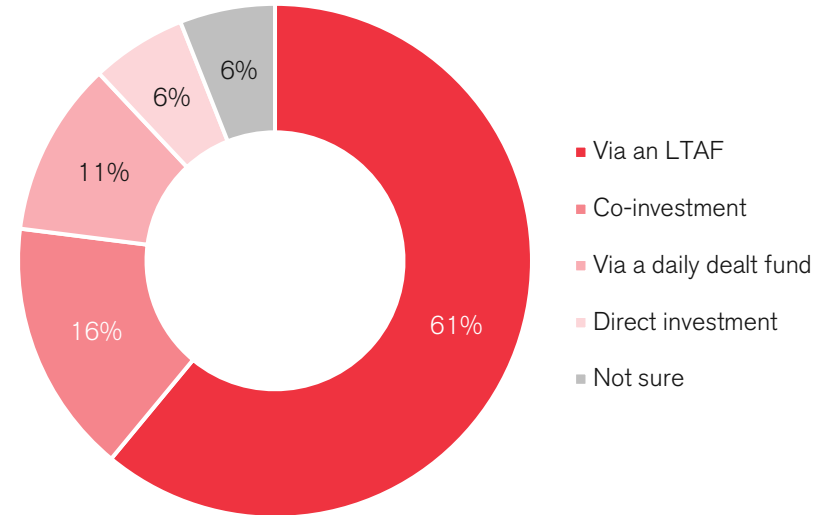
	Closed-end funds	Lux Part II UCI funds/RAIFs	Evergreen funds-of-one	LTAFs	Listed funds - Investment trusts
DB schemes	●	●	●	●	●
DC schemes: independent from insurance platform	●	●	●	●	●
DC schemes: with insurance platform	●	●	●	●	●

Note: May be able to access evergreen SMAs if the pot of assets meets the permitted links rules.

Note: LTAFs are a product innovation to allow access to DC funds, they are mostly relevant for insurance-linked DC schemes, which make up the majority of the UK DC market.

● Permitted
 ● Permitted, but not preferred
 ● Not permitted

Figure 16: Absent any constraints, how would you prefer to access illiquids?



Source: The Defined Contribution Investment Forum, 2024.

Key takeaways

The UK pension system is complex and currently undergoing several reforms impacting its different segments. Although throughout the years, managers saw a decline in commitments from UK pensions as many DB schemes closed, Brexit and the government's need for growth are now providing new opportunities for private capital. The three main themes across the reforms are consolidation/scale, investments in private assets and investments in the UK.

- The private DB schemes buy-out market is growing at a significant rate and is creating important opportunities for secondaries managers as pension schemes look to sell their illiquid positions that are unattractive for insurers.
- The proposals regarding allowing employers to share in pension surplus and the proposed Superfund regime, if implemented, are both expected to incentivise investment in higher returning private investments.
- LGPS pools will continue to grow through consolidation in coming years. Managers must adapt to new dynamics and build relationships primarily with the pools, several of which have open mandates for private asset managers.
- DC schemes are also being encouraged to invest in private assets but there are still important barriers to consider. It is crucial to understand their use of unit-linked policies to determine how they can best access alternative assets. For those impacted by permitted links, LTAFs are the preferred solution as they fit directly into the regulatory framework.

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Endnotes

1. Investment Management in the UK 2022-2023 ([theia.org](#)).
2. According to PPI DC Future Book 2023 ([publishing.service.gov.uk](#)).
3. Labor Party 2024 Manifesto ([labour.org.uk](#)).
4. Figure only includes the England and Wales LGPS.
5. Chancellor vows 'big bang on growth' to boost investment and savings ([gov.uk](#)).
6. Local Government Pension Scheme (England and Wales): Next steps on investments, November 2023 ([gov.uk](#)).
7. Across the scheme as of March 2022 £145 billion or 39% of assets have been transferred to the pools with the percentage varying by pool from under 30% (LGPS Central) to over 80% (LPP). Local Government Pension Scheme (England and Wales): Next steps on investments, November 2023 ([gov.uk](#)).
8. LGPS Scheme Advisory Board - Asset Allocation, 2023 figure ([lgpsboard.org](#)).
9. Defined benefit pension schemes - Work and Pensions Committee ([parliament.uk](#)).
10. Other insurance solutions also exist e.g. longevity swap agreements (where longevity risk but not asset risk is insured).
11. Cashflow matching for insurers and pension schemes ([abrdn.com](#)).
12. Legal & General survey from March 2024 ([legalandgeneral.com](#)).
13. Some inflation-linked assets are permitted.
14. When pension schemes are already engaging with insurers other options exists such as agreeing a deferred premium.
15. Other solutions such as deferred premiums or loans also exist, however the trustee would still be exposed to investment risk.
16. Several schemes became overallocated to illiquid assets as cash collateral requirements had to be met with cash.
17. Tesco pension sells £1bn pound PE portfolio to multiple buyers ([buyoutsinsider.com](#)).
18. Secondaries Investor ICG LP Secondaries secures over \$200m portfolio from UK pension Cummins ([secondariesinvestor.com](#)).
19. UK pension funds snap up real estate at steep discounts ([ft.com](#)).
20. WTW launches Illiquid Assets and Buyout Specialist Group ([wtwco.com](#)).
21. Some elements of these rules are already in force, others will come into force in December 2024. PS10/24 – Review of Solvency II: Reform of the Matching Adjustment ([bankofengland.co.uk](#)).
22. Sub-investment grade assets were considered "inefficient" for matching adjustment inclusion and, according to Schroeders, accounted for less than 1% of UK matching portfolios in October 2023 ([schroeders.com](#)).
23. Timeline for completion is unknown.
24. According to the consultation "Options for Defined Benefit schemes" which was opened in February 2024 ([gov.uk](#)).
25. The term "productive finance", which is often used by government, does not have a formal definition. However, it is often described as investment that expands productive capacity, furthers growth and can make an important contribution to the real economy. Examples of productive finance include: plant and equipment, research and development and infrastructure. This includes both private equity and private debt related to these sectors.
26. This figure implies a market size of £1tr. It is most likely that this figure also includes contract-based DC schemes as currently trust-based schemes only manage approximately £270bn ([theia.org](#)).
27. Chancellor vows 'big bang on growth' to boost investment and savings ([gov.uk](#)).
28. According to the Mansion House Compact Background & FAQs ([theglobalcity.uk](#)).
29. Included in the Pension Schemes Bill announced during the King's Speech ([gov.uk](#)).
30. Comparable schemes must be larger than £10bn.
31. Included in the Pension Schemes Bill announced during the King's Speech ([gov.uk](#)).
32. During the Spring Budget speech, Jeremy Hunt stated he would continue to explore "how savers could be allowed to take their pension pots with them when they change job". Spring Budget 2024 speech ([gov.uk](#)).
33. According to Aegon, over 90% of those in company pensions will tend to remain in the default option ([aegon.co.uk](#)).

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