



Illiquid Assets

Further insights on the DC Master Trust market

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isio.

The UK DC Master Trust providers are fast evolving their plans for the inclusion of illiquid assets within their default strategies, with a number of solutions already live.

In our first paper, [Illiquid Assets – DC Providers](#), we looked at the initial plans of a number of the major commercial UK DC Master Trusts in the market. However, transparency on plans varied significantly, with many providers offering limited details beyond stating that plans were “in the pipeline”.

Now, with renewed impetus from recent government initiatives (Mansion House speech 2024) and the market’s increasing focus on value over cost, we are seeing these initial plans evolve considerably and start to translate into live solutions.

Our second paper delves deeper into those plans, including providers’ target asset allocations, the use of different illiquid asset classes, their approach to managing liquidity, and some key implementation considerations.

However, we note that plans may change, therefore, this paper represents providers’ current best estimates of their direction of travel. In addition, although the majority of providers are also planning to incorporate illiquid assets during the de-risking and at-retirement phases, these plans are less developed. Therefore, this paper focuses on the growth phase only.

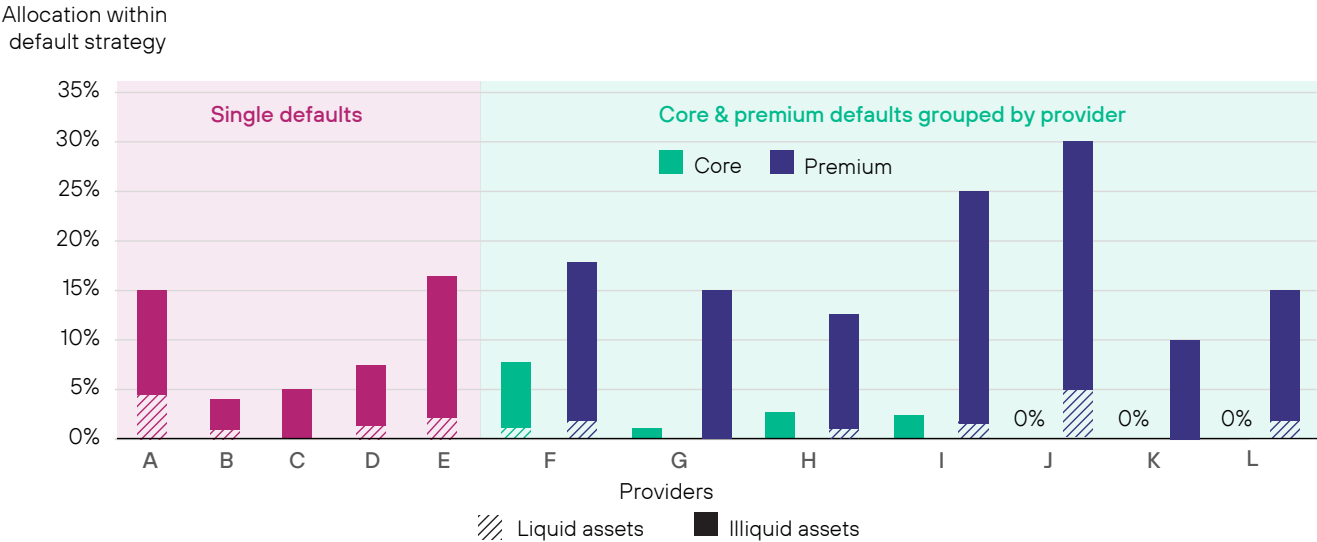
Very simply, we define illiquid assets as those which cannot be bought or sold easily, i.e. non-listed assets including Private Equity, Private Debt, Property, Infrastructure, Natural Capital among other asset classes.



Size of illiquid allocations?

As noted in our previous paper, providers are either opting to retain one single default or move to a 'Core and Premium' model covering two cost points and different levels of sophistication.

What allocation to illiquid assets are providers targeting in the growth phase across their range of defaults



Note: Providers J, K and L are not planning to include any illiquid assets within their equivalent core defaults.

The above chart illustrates the allocation to illiquid assets in the growth phase across core, premium, and single default solutions, including how much liquidity is used within these illiquid fund structures.

Seven providers have opted to go down the core and premium default route. Under this approach the premium defaults (blue bars) have the highest allocation to illiquids. Four of these providers will also include allocations to illiquids within their core default (green bars), whilst three providers intend to have no allocation within their core default (not shown on the chart). For the five providers offering just one default (pink bars), unsurprisingly the illiquid allocation sits on average between the core and premium defaults.



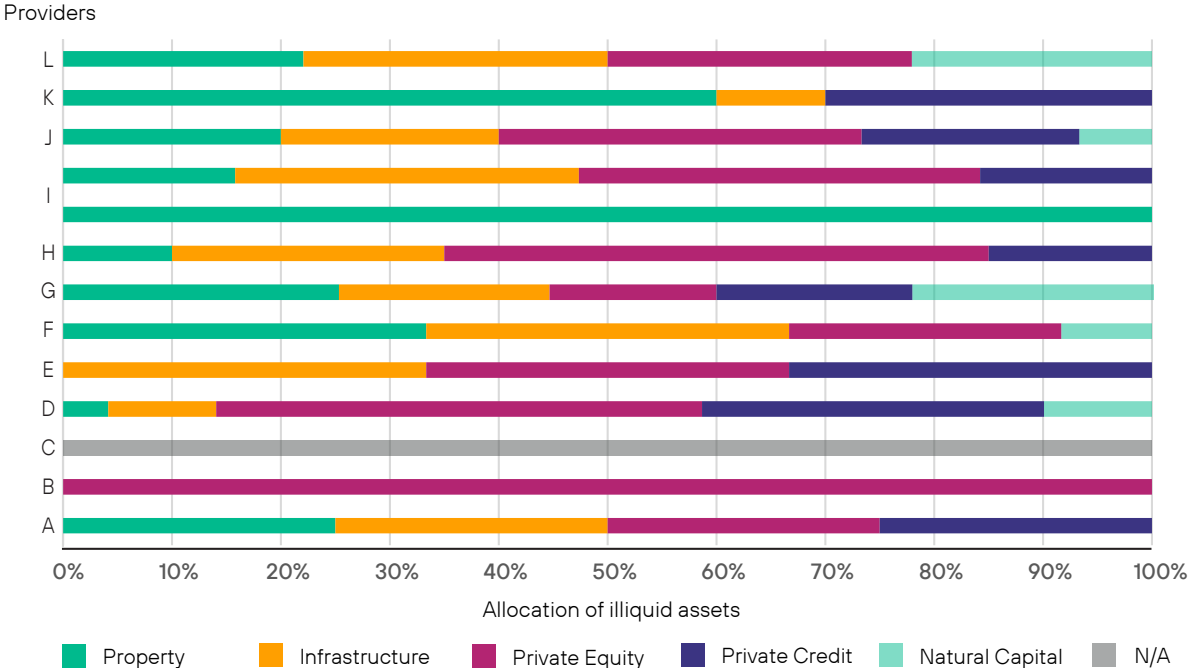
Isio view

We can see arguments for adopting either a “core/premium” or “single” default approach and the range of approaches on offer provides genuine choice in the marketplace to pension schemes. The key unknown currently is whether investors will be willing to accept the *certainty* of paying a higher price but with the *uncertainty* of expected better member outcomes. This uncertainty and additional concern around how existing clients will react to a price increase has led in our view to the “core/premium” approach being the most popular in the market currently. However, following the 2024 Mansion House speech, there has been increased discussion around whether providers will migrate to offering just one default (although as of yet we haven’t seen any movement on this point).

Which illiquid asset classes?

Among the various asset classes, private equity and real assets emerge as the most popular choices.

What illiquid assets are providers planning to use?



Note: Provider C did not provide a breakdown of their proposed illiquid allocation. Providers F, G and H are intending to use the same underlying illiquid asset mix between their core and premium defaults. Provider I has different illiquid allocations for its core default (lower line) and premium default (upper line).

The three most popular asset classes within each provider’s illiquids allocation are property (green), infrastructure (yellow) and private equity (pink). This encompasses two-thirds or more of each providers’ asset allocation. Private equity is typically the highest returning aspect of any illiquids allocation, whereas property and infrastructure are often together referred to as ‘real assets’ due to their inherent inflation linkage.

Private credit is also a meaningful but lower allocation versus the three asset classes above, largely due to expected returns often being lower due to where it sits on the capital structure. We are also starting to see providers take a greater interest in natural capital, reflecting the fact that illiquid assets are where greater impact can be achieved from a sustainability perspective. Natural capital can come in a variety of different forms, with the most popular area typically being forestry.

3 out of the 4 providers who are operating a “core/premium” dual default approach, and with illiquid assets in both, are intending to use the same underlying illiquid asset product (and therefore have the same illiquid asset class mix) but on an increased scale for the premium defaults



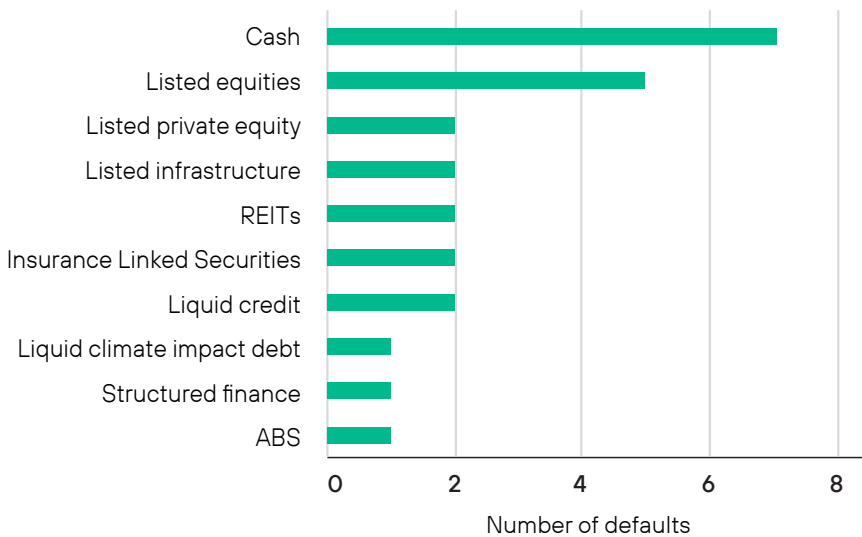
Isio view

We favour an illiquids approach that is well-diversified by asset class. Some care needs to be taken in the categorisation above as the asset segments are so broad. In our view, how and where assets are invested within each asset class segment will be as important (if not more so) than the allocation to the above high level asset classes. Although we would support a ‘core’ allocation to private equity, property and infrastructure, it is encouraging to see providers looking outside these asset classes to other areas. For example, looking back, private credit, if invested well, has delivered superior risk-adjusted returns versus other illiquid asset classes targeting a higher return.

How are they managing liquidity?

Within the liquid portion of LTAFs, providers are utilising a variety of asset classes to maintain liquidity.

What assets are providers using to provide liquidity?



Cash is the most popular choice due to its unparalleled liquidity. However, many providers are complementing cash holdings with higher-returning liquid assets, such as listed equities or liquid credit assets like Asset-Backed Securities (ABS).

While liquidity remains the main concern, providers must also manage the risk of cash drag to avoid significantly impacting overall performance, and ultimately member outcomes. This balance ensures that the funds can meet redemption requests efficiently while still aiming for optimal returns.



Isio view

It is crucial for providers to have a well-defined plan for managing liquidity. While strong cashflow pipelines may make this straightforward in the short term, it is essential to plan for scenarios where this may not be the case.



Internal or external management?

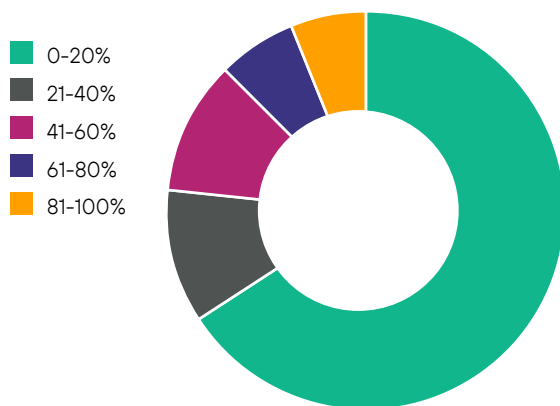
The majority of providers are proposing to make extensive use of external managers for their illiquid assets allocation, given the desire for specialist expertise.

The chart below illustrates how much of the illiquid asset allocation will be managed internally, based on providers' current expectations. Most providers are expecting to look externally for the underlying illiquid asset managers, with only a minimal (up to 20%) allocated managed internally.

However, understandably, there are a small handful of providers who have an existing asset management arm to their business and therefore will be looking to make use of these in-house capabilities where possible.

The illiquid investible universe is vast, encompassing private equity, real estate, infrastructure, hedge funds, private debt, and more. Given its breadth, it is challenging to maintain expertise across all these diverse asset classes, each requiring specialised knowledge and skills. It will be interesting to see how providers' approaches to internal vs external management evolves over time.

How much of the illiquid allocation are providers going to manage internally?



Note: Providers in the 0-20% range include many that will manage 0% of the assets internally.



Isio view

We are seeing some providers favour the use of in-house teams where they have existing capabilities. However, in general, we believe that external specialists bring a deeper level of expertise and a more nuanced understanding of specific asset classes, leading to better investment decisions and member outcomes. We would encourage providers to ensure that the use of internal resources is not solely driven by cost efficiency considerations.

How much will be allocated to the UK?

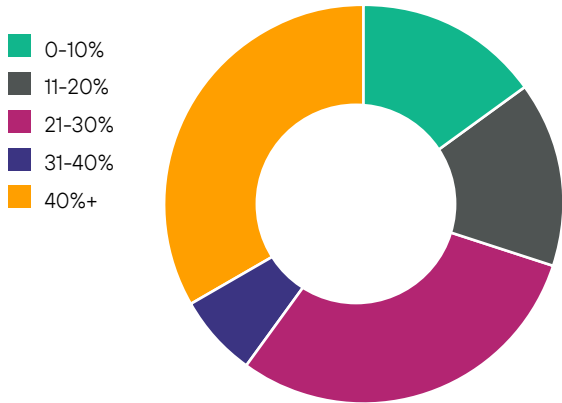
Amongst other things, one of the aims of the Mansion House reforms in 2023 and 2024 is to boost investment within the UK, prompting the question: how much of the illiquid asset allocations are providers planning to invest domestically?

The responses vary significantly, but the most common answers indicate plans to invest either 21-30% or over 40% of the illiquids sleeve directly within the UK.

From our discussions with asset managers, real assets have emerged as the most popular asset class for UK-based investments.

Based on the responses we received, most providers are currently considering UK venture capital but as part of a wider private equity allocation as opposed to a distinct stand-alone allocation.

How much of the illiquid assets allocation are being invested in the UK?



Isio view

While we acknowledge the Government's intention for UK-focused investments, from a risk-return perspective, we favour considering the UK as part of a wider global allocation within a diversified illiquids allocation. We note that there are arguments being considered around whether investing in UK illiquids could lead to greater member engagement (based on the investments being more relevant for a UK-based member) and / or whether the concept of fiduciary duty should be broadened to consider the impact of the investment on the environment that a member operates within.

Implementation and ramp-up



Implementation

Most providers plan to use LTAFs to implement illiquid solutions, with many introducing private markets to the growth phase of their defaults throughout 2025.

Investment timelines vary by provider, asset type, and fund structure, with some already deploying capital into illiquid assets.



Fund Structures

Within the LTAFs, providers are considering a mix of open-ended, evergreen, and closed-ended structures.

Evergreen and open-ended structures allow quicker investment. In contrast, closed-ended structures may take 2-4 years to reach full investment. This time to ramp-up adds additional complexities as providers need to consider how to mitigate the J-curve.



J-curve

The J-curve is a concept that illustrates how returns on private assets typically start negative as capital is deployed and expenses outweigh early gains; before then shifting to positive returns as portfolio companies grow and investments are exited.

To mitigate the J-curve, providers are considering the use of secondaries, diversifying across vintages, participating in co-investment opportunities, and using evergreen structures that continually reinvest capital.



Ramp-up

As the asset managers search for high-quality illiquid investments, providers are either planning to draw down capital from the existing growth phase as opportunities arise or investing in listed private market assets as proxies for future illiquid allocations.



Isio view

Integrating illiquid assets into default strategies presents intricate challenges beyond just investment considerations. Drawing on our extensive experience with DB, DC and Master Trust clients, we recognise the critical importance of meticulous governance and thoughtful implementation. We would encourage providers to place particular emphasis on the unique challenges for DC investors including liquidity management within broader default solutions, managing potentially unknown redemption requests and value for member / performance reporting.



Watch out for our next paper on illiquid assets

In which we will delve deeper into LTAFs and some key design considerations, but we also take a look at some alternative private market fund structures.

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Data was requested from the following Master Trust providers. Please note that not all providers responded to every question, therefore some have been excluded from the charts shown above.

- Aegon
- Aviva
- Aon
- Cushon
- Fidelity
- Legal and General
- LifeSight
- Mercer
- NEST
- NOW: Pensions
- The People's Pension
- Scottish Widows
- SEI
- Smart
- Standard Life

We note that providers plans are evolving at rapid pace, data contained within represents data collected as at January 2025.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.