Mansion House Accord

It's all in the implementation!

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isio.

This is the third paper in our series on private market (or illiquid assets) investing within defined contribution (DC) pension schemes. This time, we focus on the recent Mansion House Accord announcements, their likely impact on the market and set out important implementation considerations for potential investors.

On Tuesday 13th May, seventeen of the largest workplace pension providers in the UK signed a voluntary initiative, known as the Mansion House Accord, expressing their intent to invest at least 10% of their DC default funds in private markets by 2030, with 5% of the total allocated to the UK. This Accord built on the Mansion House Compact which was signed by eleven providers in June 2023.

The signing of the Accord represents a continuation of two themes which have dominated UK DC investment discussions over the last 12-18 months – i) DC schemes should invest more in private markets to improve member outcomes and ii) the UK government's push that a significant proportion of this investment should be directed to the UK.

In this paper, we address these themes by considering three key questions:

1. **To what extent are DC pension schemes investing in private markets at the current time?**
2. **How could the Mansion House Accord change this, and is it for the better?**
3. **What are the key implementation questions that need to be considered when investing in private markets?**

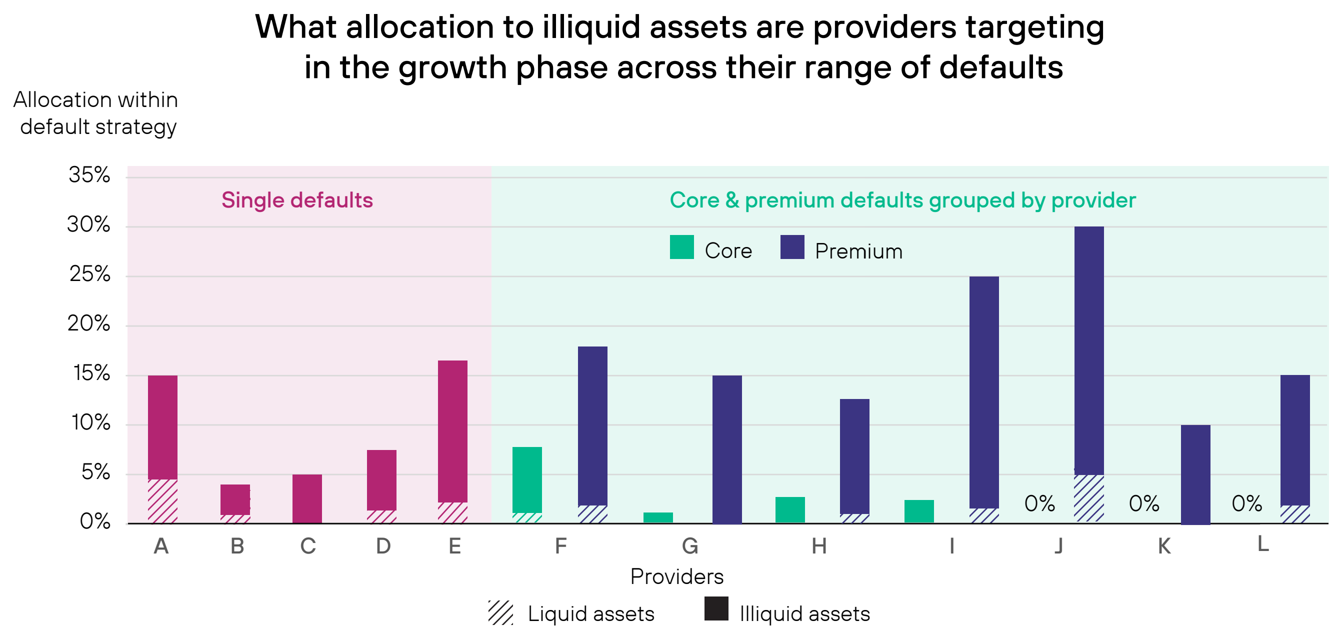
We believe that currently the debate is too focused on **whether** to invest in private markets or not, with an implicit assumption that investing in private markets provides a "golden ticket" to guaranteed better member outcomes. We agree that when done well, investing in private markets should lead to better member outcomes.

However, there are still significant question marks around **how** a number of providers /DC schemes are planning to implement any meaningful allocation. In our view, not enough attention or scrutiny is currently being placed on this. These implementation issues represent the biggest challenge (and opportunity) for the forthcoming years and we explore this is in more detail in this paper.

1. To what extent are DC pension schemes investing in private markets at the current time?

Our previous research paper "Illiquid Assets – Further insights on the DC Master Trust market, February 2025", details how the largest DC providers are looking to allocate to private markets in their main defaults. We share some of the key conclusions which still hold true from this paper below.

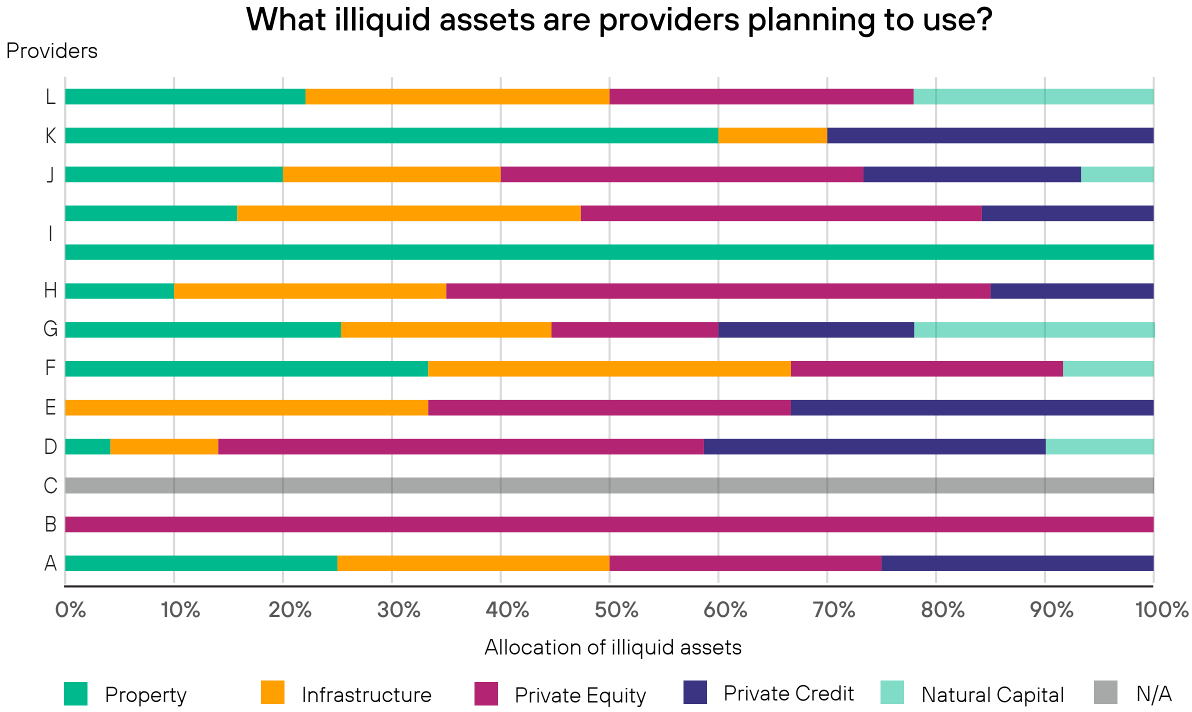
The chart below shows that the provider market is currently polarised between those intending to offer **one default** with an allocation to private markets (pink bars) versus those that are looking to go down what is often referred to as the **"core and premium route"**. These providers will typically have a smaller or no allocation to private markets in their core default (green bars) and a much higher allocation in their premium default (blue bars).



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

Source: Isio, Illiquid Assets - Further insights on the DC Master Trust market, February 2025

The chart below illustrates the mix of private market assets accessed. The three most popular asset classes within each provider's proposed private markets allocation are property (green), infrastructure (yellow) and private equity (pink).



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).

Source: Isio, Illiquid Assets - Further insights on the DC Master Trust market, February 2025

Although the charts above show what DC providers are doing in relation to private markets (as this is the most accessible data), we are observing similar trends for those trustees / companies building their own defaults.

2. How could the Mansion House Accord change this, and is it for the better?

We expect the signing of the Mansion House Accord will likely have four main outcomes on how DC Trusts will consider investing in private markets.

A Whether illiquids are considered or not

Positive change

The signing of the Mansion House Accord will further influence DC Trusts to consider the introduction of private markets as part of capital allocation. This is positive as we think for too long DC schemes have not given private markets due consideration. The ability to invest in private markets has always been there, and we believe too often the wider market has focused on cost as opposed to what is best on a "net of fees basis" for members. In our view, this is what has driven the lack of innovation and investment in private markets, not the ability to access them.

Our philosophy is that when integrated into default portfolios effectively, private market assets can improve expected returns, diversify risk and allow sustainability to be more effectively integrated enabling DC Trusts to have a real-world impact in a meaningful way. This should lead to better outcomes for members – so we see this as a real positive change.

B The sizing of any allocation

Positive change

By setting the minimum target allocation of 10% in private markets, the Mansion House Accord is likely to cause DC schemes to see this as the minimum starting point for a target allocation to illiquids. We are supportive of this, as our view is that for any investment to justify its inclusion, it needs to have an impact on the bottom line for members.

Although a lower allocation than 10% could be justified from a "dipping one's toe in the water" perspective, we believe too often smaller allocations have been made from purely a "window-dressing" perspective. We see no real logic for forming a view that private markets are beneficial and then allocating only a few percent to it. We therefore see Mansion House's benchmarking of the market towards at least a 10% allocation as a positive change. Although the natural next question is then to ask "does 10% go far enough?" For example, the Australian Superannuation funds hold up to 38%* of their assets in private markets.

*Source: APRA Quarterly Superannuation statistics - December 2024

C The “core and premium” approach

Jury is out

Over the last six months, we have started to see a switch in industry opinion on the issue of one or two defaults. To start with, the market centred around the “core and premium approach”. The logic of this was to provide schemes / companies with a choice. However, as the pressure around private market investing has intensified and the value in investing in this asset class has been observed, we are starting to see a lot more noise around offering just the one default going forward.

At the moment, this is just a shift in rhetoric not actual action. However, the market has watched with interest the positive press (and lack of client losses) that those Trusts who have gone with the one default with illiquids have garnered. A key metric here may be how independent trustees and consultancies (who are often the “gate-keepers”) react in their recommendations to clients. In addition, it will be interesting to see how providers look to navigate any fee guarantees they have in place with current clients.

We remain torn here. We do support the idea that if you believe in private markets and implement them effectively then they should be available to all members as they should improve member outcomes. However, we do accept that there can be strong views and beliefs around private markets (in a similar fashion to Sustainable Investing).

From our perspective, the jury is still out here, largely because a number of the implementation issues identified in the next question remain unresolved currently.

D Investing in the UK

Jury is out

One thing is clear – there is a strong push from the UK government for UK pension schemes to invest more in their home market. This is arguably the most charged aspect of the current debate around illiquids, with commentators debating how much this is being driven by a political agenda versus there being general economic benefits for everyone of greater investment in the UK. In addition, there are increasing challenges to what represents the “fiduciary duty” of a Trustee and how much it should take into account the wider environment a member exists in versus just financial outcomes.

It is undoubtedly true that the level of domestic investment by UK DC schemes is less than in some of the other major global countries – c.22% of UK DC assets are invested domestically, compared to c.55% in Australia’s Superannuation system.* On the other hand, the UK market is only a small proportion (3-4%)** of the global market; to invest in the UK requires the need for opportunities and incentives to do so (both are scarce currently); and basic economic theory tells you that one of the biggest risks of focusing any illiquid investment in one country is the associated political risk.

We believe the jury is still out on the merits of this. If the UK government can genuinely support the industry in creating both opportunities and incentives, there still is a potential for a “win-win” scenario. Our concern at the moment however is that the rhetoric around this is not being backed up by any potential change in approach by the UK government. There is still time to change, but the current position gives us a genuine cause for concern.

*Source: DWP Pension fund investment and the UK economy, November 2024

**Source: MSCI ACWI Index - April 2025

3. What are the key implementation questions that need to be considered when investing in private markets?

The latter two points (C and D) in Question 2 above are indicative of a wider concern that is not being focused on enough in the debate around private markets and DC.

In our view, too often the debate focuses on **whether** to invest or not in private markets. This underplays the importance of **how** any private market allocation is implemented. We believe proper consideration around some of these implementation issues will be the biggest driver to whether a private markets allocation genuinely leads to better outcomes for members.

We expect any decision-maker on investing in private markets should consider the following:

A Are we considering the full range of private markets?

Private markets are often talked about universally in a similar vein as hedge funds. They are not however a homogenous asset class, and the options vary from asset classes that can provide a return significantly into double digits versus a "steady eddie" that churns out a regular yield of 6-7% p.a.

A lot of the focus and discussion to date has been around the more high-octane asset classes like private equity and venture capital. We would encourage any investor to consider the full range of asset classes and not forget those at the "less exciting end" of the return spectrum such as private debt. Preqin's 2023 Global Private Debt Report observed that private debt delivered annualized returns of 8-10% with volatility of c.7% over the past decade, while private equity returned 12-14% p.a. but with volatility exceeding 15%."*

*Source: Preqin - Global Private Debt Report 2023

B Are allocations too concentrated by manager?

Given the wide variety of asset classes, we think it is very difficult for one manager to be strong across all asset classes. The skillset required to manage private equity successfully is very different to property, which is different again to natural capital. We have a concern that too many of the DC providers' private markets allocations are overly concentrated in a small number of managers and/or over-rely on the provider itself as the investment manager.

Although managing in-house undoubtedly will have cost and governance benefits, in our view these benefits may be more than outweighed by the returns that could be lost by investing with the wrong managers. For example, the top quartile returns of private equity managers over the last 10 years were 20-30%+ p.a., in comparison with bottom quartile returns of only 5-10% p.a.**

**Source: Preqin - Global Private Debt and Global Private Equity Reports 2023

C Is cost still too big a driver?

It is refreshing to see the DC market begin to focus more on "value" versus "cost", but we question whether this is going far enough. It is true that a number of investment managers are very keen to break into DC and therefore attractive deals can be done. However, a lot of diversified private market mandates can often land in the 100bps to 125bps range and a fee increase of 10bps to 15bps for the inclusion of private markets in the default strategy is increasingly becoming the norm.

At these relatively modest fee levels, there are likely a number of excellent private market managers (in the more expensive areas like private equity) which are being ruled out of consideration on the basis of fees. Again, we remain concerned that this might impact ultimate net of fee outcomes for members.

D Is there too much pressure to ramp-up quickly?

Building a private markets allocation requires careful and thoughtful implementation and should not be done in a rush. Unlike more liquid markets, a poor decision cannot be easily undone and can have implications for many years to come.

We are concerned that there is increasing pressure in the DC market for providers and products to build their private market allocations as quickly as possible – this is only being compounded by Mansion House and the increasing use of 'consultant league tables'. This effect could be even more intensified with the increasing focus on investing a significant portion in the UK market.

E How does investment in the UK work?

As noted in Section 2, we think the jury is out on the merits of investing 50% of a private market allocation in the UK. We understand that there are potential benefits for the UK economy long-term and this could improve the environment that members live in. However, to make this a genuine possibility this requires more than just words from the UK government.

It requires the provision of sufficient opportunities to invest in, incentives (e.g. tax breaks) to investors that compensate for moving away from a traditional "global" approach and comfort that when political winds change, pension schemes (and in particular members) will not be left regretting the decision to bias any private market portfolio to the UK. All of these are solvable and there is time, but we remain to be convinced.

F Are LTAFs the best implementation approach?

Long-Term Asset Funds have done a great job of helping bring DC investment in private markets into the mainstream. However, we question whether long-term they will remain the preferred solution for investing in private markets in DC. If we take learnings from other areas (such as defined benefit (DB) schemes) and other geographies (such as Australia), we see much greater use of custodians in helping to build efficient private market allocations.

As pools of assets grow in DC, we expect to see a gradual migration away from LTAFs (for medium to larger-sized schemes) to more custodial approaches for managing private market allocations. LTAFs will however likely still retain a role as a lower governance option for smaller schemes. This migration should lead to lower costs and less drag on returns from the liquid assets that exist within LTAFs.

G Do consultancies / providers have the skills to build and monitor private market allocations?

If we go back a few years, the majority of DC defaults were a mixture of equities, diversified growth funds, corporate bonds, gilts and cash. The inclusion of private market allocations therefore represents a significant uptick in the level of complexity required to manage and monitor the default strategy. This area is new to both providers and consultancies.

It is therefore critical to take learnings from other areas, in particular DB schemes, where the inclusion of private markets has been commonplace for decades. We would encourage any investor to challenge their consultant and provider to demonstrate that they have the necessary breadth and depth of experience to advise on private markets. In our view a team that has only ever done DC will be on a steep learning curve and one where we would not want to gamble members' pots on them getting it right.

H How are operational and liquidity risks managed, and what does the aftermath look like?

It is easy to get distracted by the additional excess returns that are achievable from investing in private markets and to underestimate the level of operational and liquidity risk that needs to be managed. We would encourage any scheme considering private markets to properly review what could happen to cashflows in a worse case scenario, to really get "underneath the bonnet" of how the assets are valued and to consider in advance of investing how performance will be monitored.

It is important to have the foresight to set appropriate plans in place around all of the above ahead of the decision to invest. As an investor, you do not want to be considering these issues in real time once you've already invested and there is less room for flexibility.

I Can I only invest in private markets if I invest through a Master Trust?

Put simply, no. Scale does provide advantages when it comes to investing, and the benefits of being able to properly join investment with engagement and post-retirement through a Master Trust is an attractive combination. However, we would challenge the government on their linkage of a credible long-term vehicle for DC to an asset value as large as £25bn. We believe that Single-Employer Trusts of much smaller size can credibly invest in private markets and that you do not have to be invested in a Master Trust to do this effectively.

As the push for consolidation continues, Single-Employer Trusts are still likely to reduce in number going forward. However, we expect there will continue to be a long tail of medium to larger Trust schemes that if governed effectively can deliver as good as a solution (if not better in some cases!) than a commercial Master Trust.

Summary of implementation considerations

The list above is a long one of implementation considerations. This is because we think the market is currently too focused on the "yes / no" decision when it comes to investing in private markets, rather than the "how". For us, the implementation questions above are as important, if not more important, than the strategic decision on whether to invest in private markets.

Final thoughts

The Mansion House Accord is another step in the right direction in encouraging pension schemes to consider investing in private market investments within their default arrangements. For too long, the market has focused on cost as opposed to value and it is exciting to see this mindset start to change.

Private markets have the ability to increase returns, allow more effective management of risk and enable sustainability to make a genuine difference. All of these are positive for members and should lead to better outcomes and more engagement.

There is however one potential spanner in the works. We are concerned that not enough heed is being paid to the effective implementation of private market allocations. Simply allocating to private markets does not give a guarantee of better outcomes – as if it's done badly, it will likely lead to worse outcomes than what's currently provided by existing defaults.

We would encourage all potential investors to challenge their providers, their consultancies and the government on the **"how"** when it comes to private markets implementation. Areas such as manager diversification, what UK investment actually looks like, speed of ramp-up, management of liquidity and the expertise of your advisor/provider can make a real difference. Remember, as the title of the paper says, it's all in the implementation!!

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