PENSIONS POLICY INSTITUTE

PPI Launch Event

What role could alternative assets play in DC investment strategies in the future?

Launch event write up:

The Pensions Policy Institute (PPI) held a policy seminar on Thursday 9th March 2023 to launch its report into the future role of alternative assets in DC investment strategies, sponsored by the World Gold Council. The event was hosted at Central Hall, Westminster.

The report explores the topic of Defined Contribution (DC) scheme investment in alternative assets, particularly in light of new opportunities and the potential benefits that could be gained from the use of these types of assets during times of economic uncertainty.

Over 50 people attended the event, representing interests from across government and industry. John Chilman, (Chief Executive, Railpen, and PPI Trustee) chaired the event.

John Chilman, Chief Executive (Railpen) and PPI Trustee, gave a chair's welcome to the event and thanked the World Gold Council, Platinum Supporters for sponsoring the report. He welcomed everyone and introduced Lauren Wilkinson, the lead researcher of the report.

Lauren Wilkinson, Senior Policy Researcher, PPI, presented an outline of the report and the key components of the research findings.

As a backdrop to the research, the report highlights an ongoing shift among DC schemes towards greater focus on long-term member needs and outcomes. The shift comes in response to economic uncertainty and changes in the DC market, which is maturing as scale and pot sizes grow, and as DC becomes the dominant form of pension provision in the UK. Together, these changes increase the spotlight on investment strategies and challenge the role of the traditional passive bond / equity splits in delivering returns and risk mitigation.

PPI research published in 2019 highlights how alternative assets can help to address these challenges as part of a diversified portfolio. At present however, allocation towards alternative assets and growth in the allocation of alternatives remains relatively low. It is challenging to gather data on specific asset allocation across the whole DC market and, as such, there are varying estimates of average allocation to alternatives, ranging between as low as 12% and as high as 30%, with large schemes more likely to engage than smaller schemes. Despite a relatively slow pace of change however, DC schemes appear to be increasingly focused on:

- Evolving and improving investment strategies
- Building quality
- Incorporating sustainability objectives
- Demonstrating Value for Money

The report discusses potential risks to DC outcomes in the event that investment strategies do not evolve in response to concerns over long-term economic growth and stability, including the ongoing effects of high inflation. It also highlights the potential benefits that alternative assets can offer, including how a longer investment horizon that can contribute to lower volatility, and greater diversification which may provide better protection against risks for members. The alternative asset classes covered by the report include property, infrastructure, commodities, private equity, venture capital and private credit. Although property remains the most widely understood type of alternative asset, the need for schemes to further diversify means that others, particularly commodities and infrastructure, could potentially offer greater opportunities for enhanced risk mitigation.

Despite their potential benefits, a number of barriers exist which are thought to underpin hesitancy towards the growth of alternatives within DC portfolios, most notably those relating to:

- Operational challenges, which can be exacerbated by a lack of scale, despite ongoing scheme consolidation
- Limitations associated with accessing alternatives through platform offerings
- Limited knowledge and expertise, particularly among smaller schemes
- Cost, competition and the need for greater focus on quality and value added by investments

Looking ahead, allocation to alternatives is expected to increase despite current allocations remaining low. Although the extent to which progress can be effective will depend on how barriers are overcome, drivers including continued economic uncertainty, changes in policy and regulation, greater government support and increased industry innovation suggest that momentum for change is gaining pace, and that a prolonged status quo looks increasingly unlikely in the future.

Response from the sponsor: Jeremy De Pessemier, Asset Allocation Strategist, World Gold Council. Jeremy thanked Lauren and the PPI for their work on the report and described the role of the World Gold Council in raising awareness of gold as a key alternative asset.

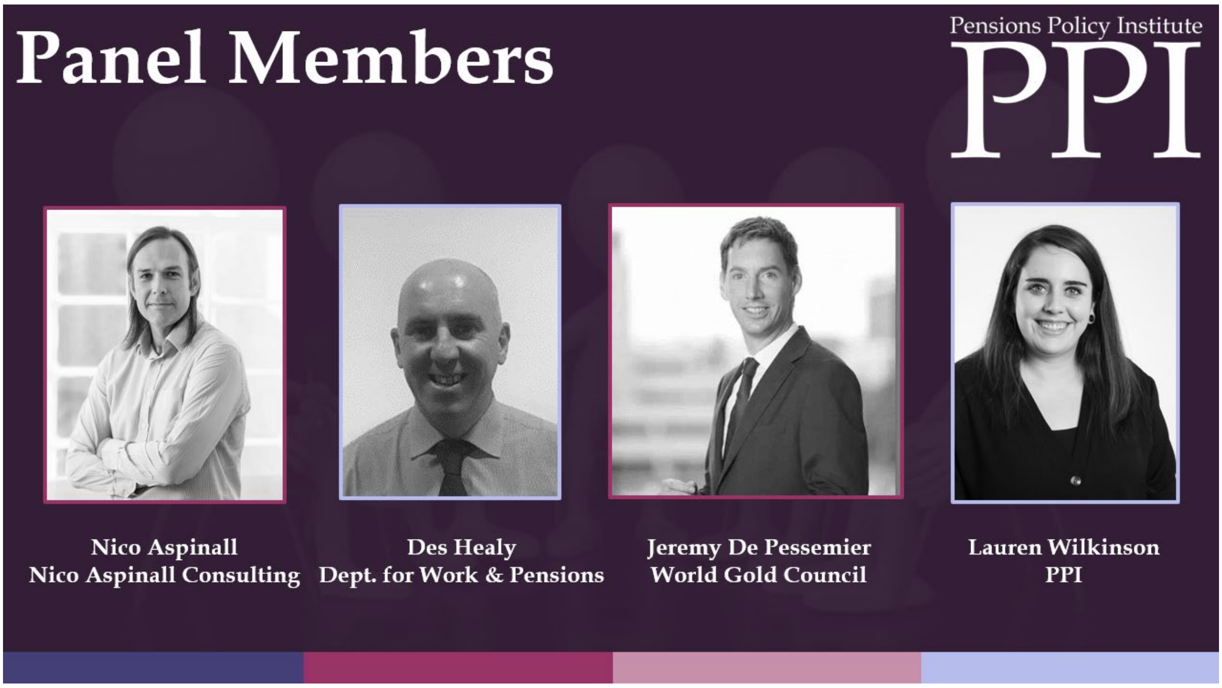
Among issues currently facing investors, Jeremy outlined the weakening appeal of government bonds as a diversifier in portfolios, and as a de-risking strategy for those approaching retirement. He also described how the importance of identifying alternative assets that can fulfil the same objectives but in a better way has become a key focus for DC schemes, and is leading to a new policy reality that looks set to challenge the traditional focus on equities and bonds. Jeremy highlighted that gold is a key strategic alternative to bonds for investors seeking greater diversification on account of its potential to improve returns, reduce volatility and mitigate against investment, inflation, longevity and liquidity risks. Past returns have demonstrated its strong performance in periods of high inflation and market downturns, as well as its strong correlation profile, positive long-term returns and outperformance against some other asset classes throughout both good and bad economic times.

Response from Des Healy, ESG, Productive Finance and VfM Policy Manager (DWP). Des described how the report makes an important contribution to ongoing discussions and work around the Value for Money framework. Its findings are consistent with government analysis which suggests that greater diversification can lead to better outcomes for savers, and that determining what could be done to tackle barriers to investing in alternative assets will be key to making progress.

Response from Nico Aspinall (Nico Aspinall Consulting). Nico outlined the role of alternative assets as a vital part of diversified portfolios, and as an important lever through which to drive outcomes. He also highlighted the challenges associated with costs, daily pricing and the operationalisation of illiquid assets, whilst describing how increasing scale can help to put pressure on industry to generate conversation and develop solutions including a custody-led approach that can help to overcome barriers to investment.

Panel discussion/Q&A:

John Chilman chaired the panel discussion and subsequent Q&A session. The panel discussion consisted of:



The remainder of the session was held under **The Chatham House Rule** and the views expressed do not necessarily reflect those of the PPI or panellists. The following points were raised during the panel discussion and the Q&A:

Value for Money

- The debate around alternative assets and VfM is often dominated by narrative and metrics that focus on cost rather than quality. There is a need for greater emphasis on the long-term benefits that alternative assets can offer to members and to the wider economy.
- The extent to which small schemes are able to offer the same member benefits as larger schemes on account of scale plays a key role in discussions around VfM, consolidation and the access that schemes have to alternative assets. Increasing scale is likely the best way of allowing schemes to diversify whilst avoiding added portfolio costs.

Barriers to alternative investment

- Widespread industry engagement will be necessary to ensure that platforms have a broad range of offerings in order to address barriers to investment associated with scale, expertise and cost.
- Regulation alone is less likely to address constraints and it will be important that any burden brought about by regulation does not hinder the momentum that exists towards driving improved member outcomes.
- There is a need to define what fair outcomes might look like in the event that assets could be exposed to mis-pricing, or that long-term returns may not materialise. This includes the need for honest discussion around the extent to which illiquidity risks are borne by members.

ESG

- The potential role of nature as an asset class was identified as an area which is broadly underexplored. There was consensus that bio-diversity is likely to become an important objective in the near future, and greater expertise across the industry will be required to develop this.

Gold as an alternative asset

- The common misconception that all alternatives are illiquid was discussed, concluding that gold is not an illiquid asset and can therefore help to mitigate liquidity risk within diversified portfolios.
- Concerns were raised over the potential for gold to comply with investors' ESG responsibilities on account of its nature as an extractive industry. Responsible mining initiatives and decarbonization in new extractions will be key to addressing these concerns, although new extractions represent a relatively low share of gold as a commodity.

Final remarks:

- Despite challenges associated with alternative assets, both engagement and momentum are high and there is a shared desire to overcome barriers to investment.
- Alternative assets play a key role in diversification and it is important that all alternative assets are demystified in order to support this process.
- Building scale, including through consolidation, will be key to reducing barriers to alternative investment, which has the potential to improve member outcomes. Industry innovation, including the potential to provide DC schemes with access to custody accounts, will also be vital.
- There was broad consensus amongst attendees that investment in alternatives by DC schemes is likely to increase in the future, but concerns that any increase will not be high enough to deliver the full potential of alternatives as an asset class to members.

A Pensions Policy Institute Report

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