Private assets may be coming to Britain’s DC plans (at a price)

By Editorial Staff *Thu, Jan 20, 2022*

Buyout firms say they might reduce their usual 2% management fees if they can keep their performance-related payouts, which are contingent on meeting return targets.

To become eligible to market their products to retirement savers in the UK—who have some half a trillion pounds ($680 billion) in their “pension pots”—private equity (PE) fund managers are considering lowering their annual expense ratios, Bloomberg reported.

But the PE firms may want bigger performance bonuses in return.

As the UK government pushes for more retirement savings to be invested into alternative assets—infrastructure, affordable housing, technology firms, illiquid products—both the government and the private equity firms have reasons to compromise.

Buyout firms say they might reduce their usual 2% management fees if they can keep their performance-related payouts, which are contingent on meeting return targets, according to the Department for Work & Pensions, the UK’s equivalent of our Labor Department.

Fees on target date funds, into which retirement savers can be defaulted (in both the US and UK) are currently capped at 0.75%. The government is asking for public comment on whether a performance fee could exceed that cap. One model being considered would see the buyout firms get 30% of any profits, instead of the usual 20%.

If they reduce their expense ratio, private equity firms could get more access to the UK’s pool of defined contribution retirement savings. That pool, the savings of millions of workers, grew 45% to 471 billion pounds between 2015 and 2020, according to the Pensions Policy Institute. Such accounts, equivalent to 401(k)s, represent the savings of millions of workers.

Resolving the level of fees “is one of the last major operational or structural issues for DC investment into private markets,” said James Monk, head of Defined Contribution Investment at pension consultants Aon Plc.

Private equity supporters say their products would help investors diversify their portfolios while investing more in the “real economy.” But pension fund trustees wonder if a performance fee can be fairly calculated for investors.

“Members will come in, go out, have different asset values, different contribution structures,” said Stephen Budge, partner at pension advisers Lane Clark & Peacock. “How do you make sure members are fairly charged for the performance they have received?”

Abrdn Plc (formerly Standard Life Aberdeen Plc), Legal & General Group Plc and Phoenix Group Holdings Plc are expected to roll out private market products should the rules be relaxed, Bloomberg reported.

Some DC pension plans already include private market strategies as investment alternatives. NEST, the public-option defined contribution plan, appointed BNP Paribas SA to run a private credit portfolio in 2019.

Last summer, NEST began seeking private equity partners to help the firm invest 1.5 billion pounds in private assets by 2024. Partners Group Holdings AG’s Generations Fund has around $1 billion in DC assets invested in private assets.