

# Achieving critical mass

How Master Trusts can use scale to enhance member outcomes in private market assets





## Abstract

An examination of the costs and benefits of private market investing, the variety of existing models for pensions seeking private market assets, and the pathway to fully-agile implementation.

UK defined contribution (DC) pension schemes have lagged both larger international peers and UK defined benefit funds in allocating to private market assets like infrastructure, real estate, private credit, and private equity. However, DC schemes are now reaching the scale needed to develop cost-effective internal implementation, strengthening their investment potential.

This paper examines the routes to private market asset implementation pursued in Canada and Australia. It explores the case for a new sector-aligned private markets manager, and the co-ordination challenges such a manager would face. Notably, it looks to draw lessons from the Pension Infrastructure Platform's life between 2011-2020.

Importantly, it finds that internalisation is not an all or nothing question, and maps the balance struck between internal and external asset management of private market assets by several large UK pension pools. Getting implementation right should enhance member outcomes by several hundred million pounds a year.

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# Executive summary

Britain's economy suffers from underinvestment. Higher levels of inward investment are needed not only to lift economic growth but also to deliver the green transition. The UK has the third largest funded pension system in the world, with £2.9 trillion of assets. But this large pool of UK-based capital has not met domestic investment needs.

The Chancellor has identified Canadian pension funds – with their large allocation to private market assets – as a potential model for UK schemes. She argues that a higher allocation to such assets would deliver a win-win for the country: better returns for savers and more investment in the real economy.

Several empirical studies find that high external management costs associated with private markets more than offset the return benefits of holding private assets over their public market counterparts. But private markets are the only route to securing access to key parts of an evolving investment landscape. And some pension systems have been able to make them work for their members, rather than simply for their fund managers.

Canadian and Australian pension schemes have reduced implementation costs such that private markets add net value to scheme investment returns. Maple 8 Canadian schemes each have the scale to internalise private market asset management. Australian Super funds, by contrast, approached internalisation collectively during their early days of life. In establishing private market managers for each of infrastructure and real estate, they were able to secure a lower cost route to private asset investment and, in doing so, brought down the market for external private assets management fees.

The pension fund landscape in Britain is far more fragmented than it is in Canada or Australia. Furthermore, it consists largely of closed private sector defined benefit schemes that are in run-off with little appetite for growth assets. However, following the success of autoenrollment, trust-based defined contribution schemes are both growing and consolidating quickly, and the government projects that by 2030 they will oversee £420 billion of members assets. The Interim Report of the Pension Investment Review published in November outlines a requirement that they each achieve £25bn AuM by 2030, though how competition concerns this requirement creates are addressed has yet to be answered. At such a size, individual Master Trusts would lack the scale of the Maple 8, but could begin to command the scale necessary to internalise private market management, cutting costs and boosting member outcomes.

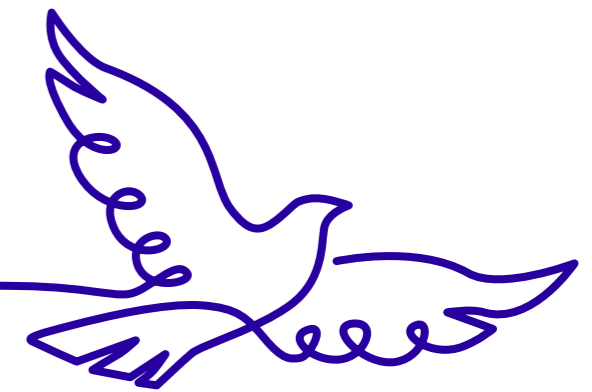
The cost of externally managing a 10% allocation of total Master Trust assets to private markets would be high. Applying external management costs to the 2030 asset base yields annual fees ranging from £560 million to £1.5 billion depending on the precise form of outsourcing. Developing high-functioning direct internal private market management capabilities could reduce this cost significantly. Reasonable estimates put projected savings to members in the hundreds of million of pounds each year.

The decision as to whether to manage internally or externally is not all-or-nothing. There is a spectrum of models that outsource different elements of private market asset management on both a single-pension fund and pooled solution basis, and the best model depends meaningfully on the scale that can be mustered. Understanding these models, and the path that large funds have taken to internalise their private market management, provides a guide as to how internal management capabilities could evolve.

There are examples of successful collective management of private market assets by pension funds. IFM Investors and ISPT were set up by a group of Australian Industry Super funds in the 1990s. Today these institutions manage tens of billions for them across infrastructure, real estate and private credit. In the UK, GLIL Infrastructure was founded in 2015 by four pension funds. It has already grown to manage £4 billion of direct infrastructure commitments.

But not every attempt at collective action succeeds. In 2011 the Pension Infrastructure Platform was formed with ten founding pension investors and the ambition to quickly originate £20 billion of direct infrastructure assets. Despite substantial political backing, this ambition was not fulfilled. PiP demonstrates the costs of embarking on a collective approach to managing private market assets without the required alignment on detailed objectives. The chances of such an approach succeeding look unrealistic amongst Master Trusts who operate as commercial competitors.

Nonetheless, large Master Trusts can chart a path towards agile internalisation to deliver benefits of lower management costs to members.



# The case for public policy intervention

**Britain suffers from underinvestment.** In the 40 years to 2019, investment in the UK averaged around 19% of GDP, the lowest in the G7. Public sector investment is low, with the average OECD country investing nearly 50% more than the UK. But private sector investment is particularly low, with the Resolution Foundation estimating that had UK private investment matched levels seen in France, Germany and the United States since 2008, UK GDP would be 4% higher today.<sup>1</sup> See exhibit 1.

This is despite returns on private invested capital being higher in Britain than it is for France, Germany or the United States over the last fifteen years.<sup>2</sup>

**Higher levels of inward investment are needed not only to lift economic growth** but also to deliver the green transition.

While the UK is a hub for seed and early-stage venture capital, there is a profound funding gap in the provision of growth equity to unlisted firms as they mature. To source growth capital, entrepreneurs increasingly need to look to US-based private equity investors – often transplanting the headquarters of successful young firms out of the UK to be closer to their owners, and removing them from the UK capital market pipeline.<sup>3</sup> Jobs

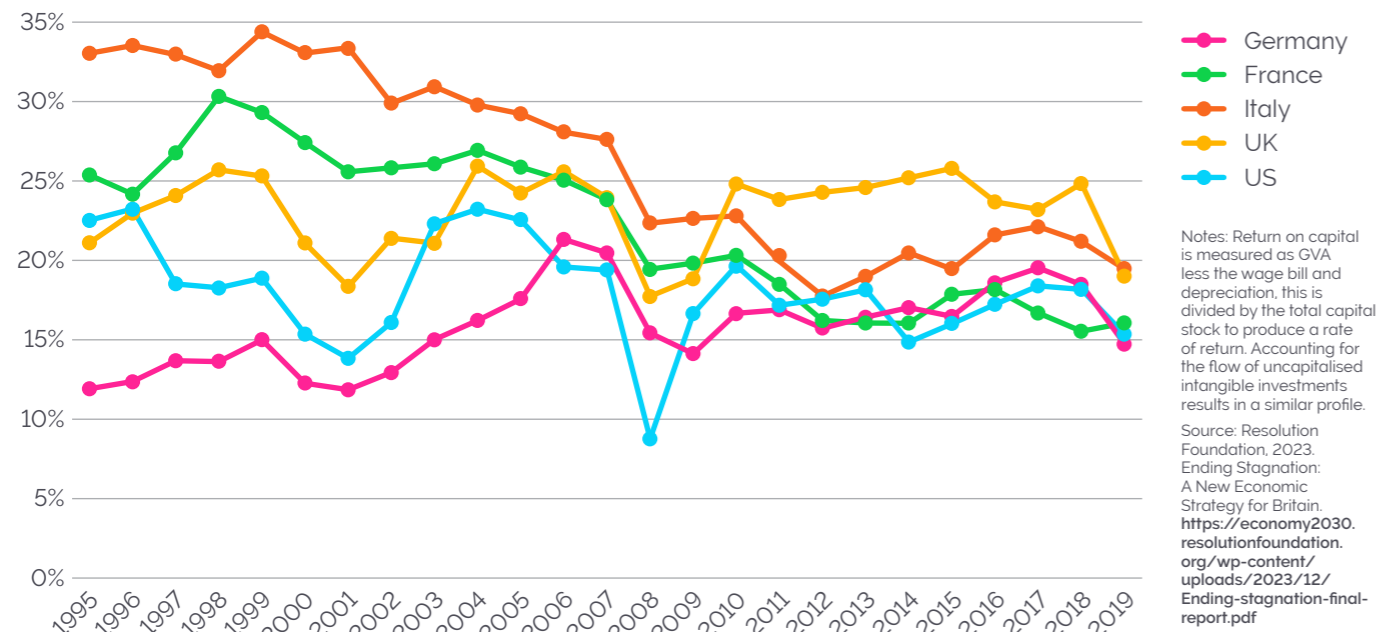
and economic growth of tomorrow are being lost along the way.

And the UK's National Infrastructure Assessment finds that in order to meet net zero commitments and upgrade digital networks, private sector investment will need to increase from around £30-40 billion over the last decade to £40-50 billion in the 2030s and 2040s. This includes around £20-35 billion per year between 2025 and 2050 from the private sector in investment in renewable generation capacity and flexible sources of generation, electricity networks, and hydrogen generation, storage and networks, and a carbon capture and storage network. See exhibits 2-3.

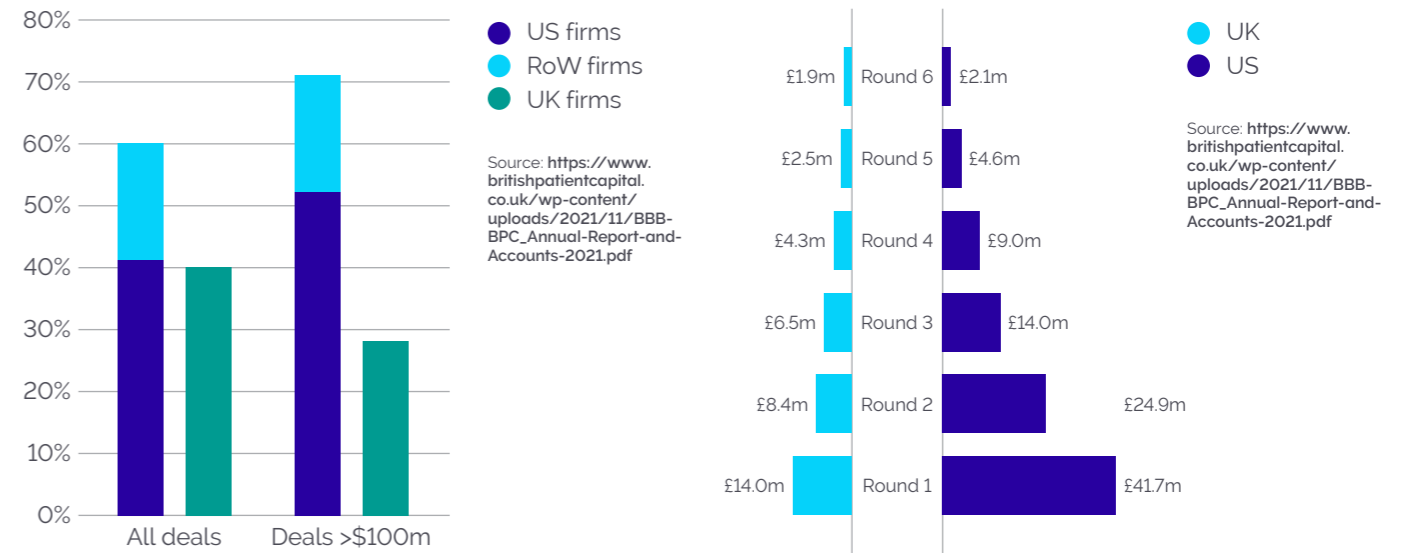
**Pools of UK-based capital are large, but have not met domestic investment needs.** The UK has the third largest funded pension system in the world, with £2.9 trillion of assets.<sup>4</sup> But allocations to private assets are small by international standards.

While data is far from comprehensive, allocations to private assets like infrastructure and private equity appear significantly higher in several other country's pension systems. Canadian and Australian pension schemes' investment in British infrastructure assets is highly visible, and allocations to private assets in both systems is substantial. See exhibit 4.

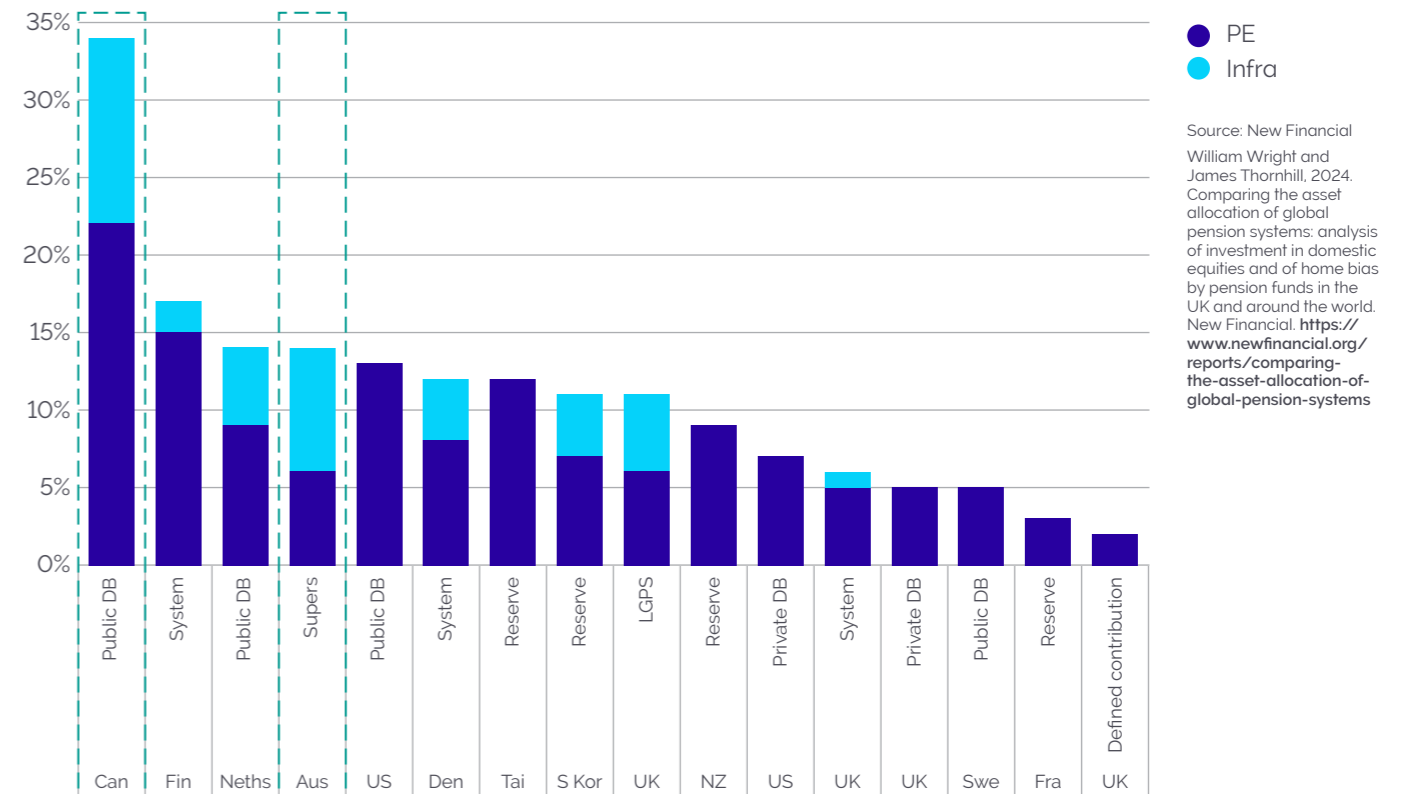
**Exhibit 1:** Aggregate return on investment, market sector excluding agriculture, by country, 1995-2019



**Exhibit 2-3:** Venture capital investment in UK firms by VC Fund nationality, 2013-2022. Average venture capital deal size for companies initially raising in 2012-22 by round size.



**Exhibit 4:** Global private assets under management, by asset type 2013-2023





Chancellor Rachel Reeves, has identified Canadian pension funds as a potential model for the UK. Ahead of a meeting with Canadian pension executives she issued a statement saying:

**“The size of Canadian pension schemes means they can invest far more in productive assets like vital infrastructure than ours do. I want British schemes to learn lessons from the Canadian model and fire up the UK economy, which would deliver better returns for savers and unlock billions of pounds of investment.”<sup>5</sup>**

Before looking more closely at the Canadian model, we will first look at whether private assets have delivered stronger returns to investors in the past, and whether there is a case from a pension member’s perspective to allocate to private assets going forward.



### BOX 1

## Does ‘Investment’ help ‘Investment’?

The idea that an increase in pension funds’ allocation to private market assets will translate into demand for spades in the ground is contestable. We use the same word – ‘investment’ – for two different things. In a macroeconomic sense, ‘investment’ describes that aspect of GDP that involves building structures and institutions that will enhance the capital stock and the capacity for future economic growth. In a finance sense, ‘investment’ refers to the acquisition of financial claims on economic output. Pension funds purchase financial claims on entities that will generate cash flows so that they can pay their members – the second use of the word ‘investment’. Purchasing an asset in the secondary market does not directly enhance a country’s capital stock or economic capacity, regardless of whether it is listed (public market) or unlisted (private market).

Private market assets are one form of financial claim on businesses – in the form of rents for real estate, debt interest for private credit, or dividends for infrastructure or private equity. Increased pension fund allocation to private credit simply switches the channels through

which firms are financed and is unlikely to have a large direct impact on economy-level investment. Increased allocations to unlisted equity will mostly increase demand for leveraged buy-outs of long-standing private or public businesses with dubious claims to boosting economic growth or socially desirable outcomes.<sup>6</sup> Although importantly, around 10–20% of the private equity landscape does consist of venture capital and growth equity allocations that provide primary equity capital to firms.<sup>7</sup>

Increased pension fund allocations to real estate or infrastructure will mostly increase demand for secondary market real estate or infrastructure assets. With strong demand in the secondary market, the conveyor belt generating such assets can – in theory – speed up. In practice, the evidence points not to weak demand but bottlenecks in supply. Increasing demand from pension funds for a particular type of asset can be legislated easily. Increasing the supply of infrastructure or real estate assets would deliver ‘investment’ in the macroeconomic sense of the word, and this requires reforms to, and better-resourcing of, the planning system.<sup>8</sup>

### Notes

- 1 P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, June 2023
- 2 Resolution Foundation, 2023. Ending Stagnation: A New Economic Strategy for Britain. <https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/12/Ending-stagnation-final-report.pdf> p153
- 3 For example, Immunocore <https://www.ft.com/content/03280cd7-8013-4212-a98e-e0c35194d009>, Marex <https://www.ft.com/content/3f07e35d-9f1d-4736-b0f3-d3114fe9693f4>
- 4 William Wright and James Thornhill, 2024. Comparing the asset allocation of global pension systems: analysis of investment in domestic equities and of home bias by pension funds in the UK and around the world. New Financial. <https://www.newfinancial.org/reports/comparing-the-asset-allocation-of-global-pension-systems>
- 5 <https://www.gov.uk/government/news/chancellor-reeves-pension-funds-can-fire-up-the-uk-economy>
- 6 For an analysis of productivity and investment of largest UK PE portfolio companies, see Ernst & Young, 2024. Annual report on the performance of portfolio companies: 16th Edition. <https://www.privateequityreportinggroup.co.uk/Portals/0/Reports/EY-Annual-report-on-the-performance-of-portfolio-companies-XVI-January-2024.pdf>. For social outcomes, see Brett Christophers, 2023. Our lives in their portfolios: why asset managers own the world. Verso Books. For care homes, see Atul Gupta, Sabrina T Howell, Constantine Yannelis, Abhinav Gupta, 2024. Owner Incentives and Performance in Healthcare: Private Equity Investment in Nursing Homes. The Review of Financial Studies, Volume 37, Issue 4, April 2024, Pages 1029–1077. <https://doi.org/10.1093/rfs/hhad082>
- 7 See Pitchbook, 2023. UK Private Capital Breakdown. September 5. <https://pitchbook.com/news/reports/2023-uk-private-capital-breakdown> [https://files.pitchbook.com/website/files/pdf/2023\\_UK\\_Private\\_Capital\\_Breakdown.pdf](https://files.pitchbook.com/website/files/pdf/2023_UK_Private_Capital_Breakdown.pdf)
- 8 See Edward Emerson, Jake Pennington, Ralph Mould, 2023. Investment and Infrastructure: The first report of the Purposeful Finance Commission. Purposeful Finance Commission, November. [https://87eecd37-3820-494b-94ad-3d87df468362.usfiles.com/ugd/87eecd\\_71dfc1647eb948a28586b6bb6108ae1d.pdf](https://87eecd37-3820-494b-94ad-3d87df468362.usfiles.com/ugd/87eecd_71dfc1647eb948a28586b6bb6108ae1d.pdf). Jake Pennington, Edward Emerson, 2024. Places and Purpose: The second report of the Purposeful Finance Commission. Purposeful Finance Commission, February. [https://87eecd37-3820-494b-94ad-3d87df468362.usfiles.com/ugd/87eecd\\_3777d6ca067a4b5bae756ce933f2b940.pdf](https://87eecd37-3820-494b-94ad-3d87df468362.usfiles.com/ugd/87eecd_3777d6ca067a4b5bae756ce933f2b940.pdf). Raoul Ruparel, Patrick Roche, Dale Williams, James Hollingsworth, Stuart Westgate, Tim Chapman, Edward Zayman, Helena Fox, and Anja Johnson, 2024. Reshaping British Infrastructure: Global Lessons to Improve Project Delivery. Boston Consulting Group, February. <https://www.bcg.com/united-kingdom/centre-for-growth/insights/reshaping-british-infrastructure-global-lessons-to-improve-project-delivery>



# The costs and benefits of private markets – a member’s perspective

Regardless of government policy, there are good reasons for pension funds to consider investing in private assets to boost member outcomes.

In this section we shall look at the case for allocating to private assets, typical investment structures, and cost challenges faced by UK pension funds seeking to gain exposure to private assets.

## The promise of private assets

There are several types of private assets, and these differ meaningfully from one another. Broadly speaking, private asset investment refers to investment in infrastructure projects, real estate, private credit, and private equity – both venture capital/growth equity, and buyout funds. What unites this disparate array of investment areas that bear radically opposite risk and return characteristics are the typical fund structures used by pension funds to gain exposure (see Box 2), and the opacity in valuation attached to a lack of public listing on the part of underlying holdings of these funds on public markets.

Unlike stocks and bonds, private assets cannot easily be traded, and theory dictates that private assets should carry an illiquidity premium – an additional

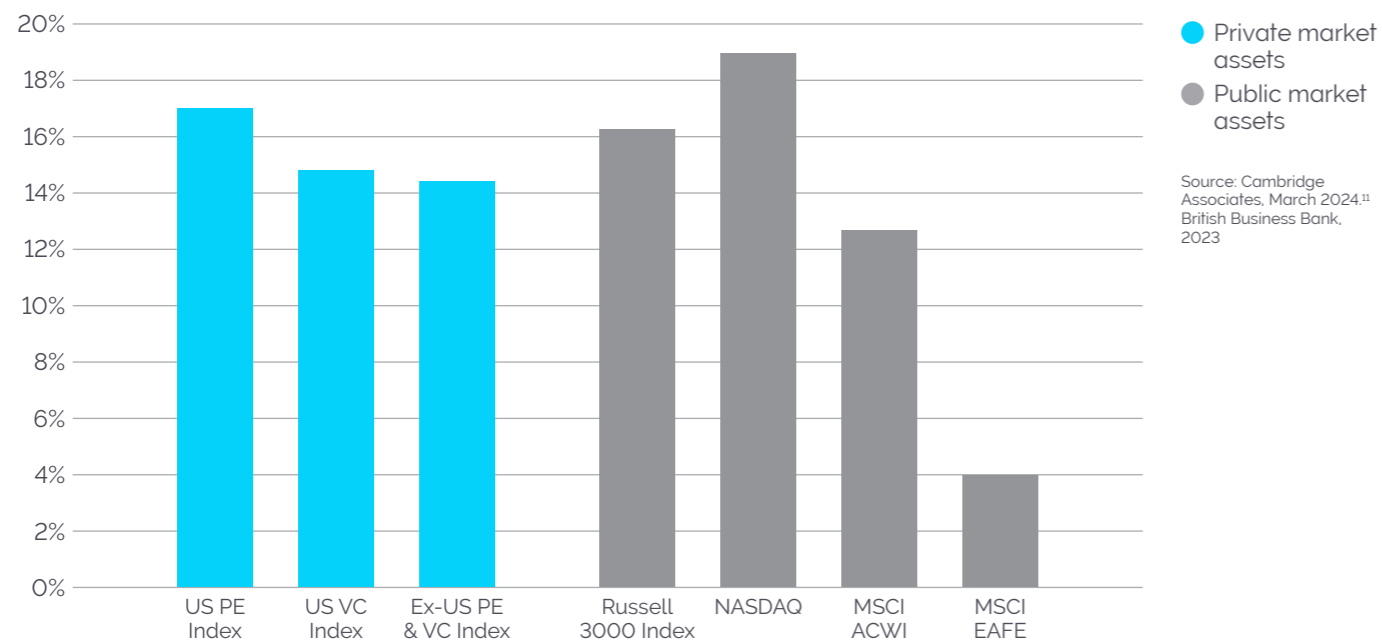
risk premium that should boost returns. This is to compensate investors for tying their assets up without any straightforward means of exit. Importantly, there is no established framework for estimating illiquidity premia ex ante. To investors with long-term relatively predictable liabilities and no desire to alter their medium-term asset allocation, this illiquidity looks like a free lunch. And so given their long-term nature, pension funds should be natural investors in illiquids.

Cambridge Associates' largely American private asset index returns have been historically strong in nominal terms. And returns from the median British venture capital funds look comparable to international norms.<sup>9</sup> See exhibit 5.

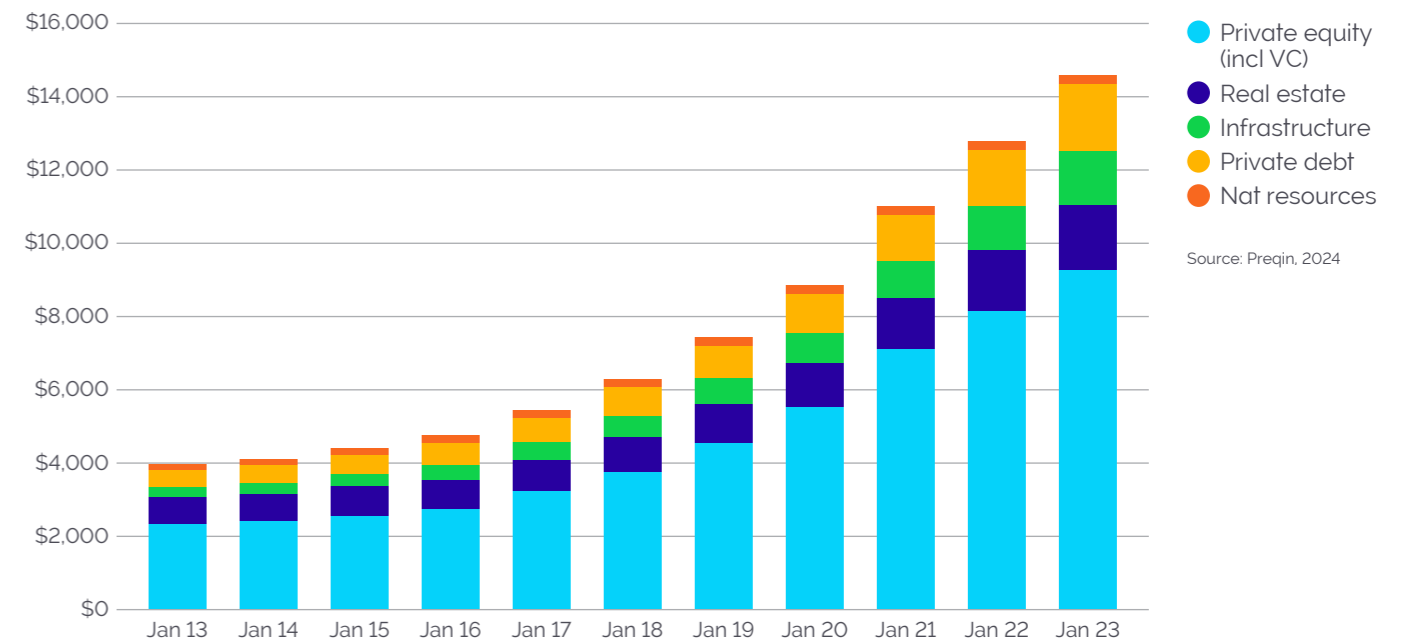
Moreover, while it is unlikely that returns from private assets will be completely uncorrelated with other pension fund portfolio assets, it is also vanishingly unlikely that returns will be perfectly correlated. As such, pension funds are likely to find useful role for private assets in their strategic asset allocations even if diversification benefits are often overstated.<sup>10</sup>

One caveat to this performance argument is that measuring and comparing the performance of private assets is not straightforward. Indices are based largely on self-reported data from GPs and are

**Exhibit 5:**  
Annualised returns of private and public market assets, 2009-2024



**Exhibit 6:**  
Global private assets under management, by asset type 2013-2023



likely to be boosted by survivorship bias. And while the preferred performance measure of private asset managers – the Internal Rate of Return (IRR) – might reasonably be thought comparable to a total rate of return delivered by a stock or bond portfolio, it is not. Even investors with private assets investments that report comparable IRRs can experience radically different investment outcomes based on the timing of cash calls and distributions.<sup>12</sup> Furthermore, use of IRRs has been shown to distort the incentives for GPs to alter the timing and size of LP cash flows.<sup>13</sup>

## Changing global investment landscape

But regardless of the complexity around performance reporting, the investment landscape is changing. Increasingly, meaningful parts of the investment landscape are becoming available only through private assets investment routes. See exhibit 6.

On the debt side, bank finance to small and medium-sized firms is starting to be replaced by the private credit market. And at the same time, an increasing proportion of large sub-investment firms have been eschewing public bond markets for private market providers, contributing to the shrinkage of public high yield bond markets. As a result of this displacement

of finance, the private credit market has grown from less than \$500bn in 2015 to over \$1.6tn in 2023. BlackRock estimate the market to reach \$3.5tn by year-end 2028.<sup>14</sup> For reference, the global sub-investment grade bond corporate market was \$1.5tn at the end of 2023 and the global leveraged loan market was \$1.4tn. As such, pension funds seeking a diversified exposure to higher yielding corporate debt need to consider allocating to this private asset class.

On the equity side, more and more firms are on the one hand choosing to take private equity capital rather than list on public markets, and on the other being taken over by private equity funds. According to Hamilton Lane, the number of publicly traded companies in the United States has fallen from 7,800 in 2000 to only 4,800 in 2020.<sup>15</sup> As such, choosing to exclude private equity from prospective asset allocations is to make an active choice to invest only in a shrinking subset of global firms.<sup>16</sup> It is not clear why an unconstrained asset allocator would do so, all else equal.

Moreover, it is principally through private structures that new capital can be deployed to secure good returns in infrastructure and real estate.

BOX 2

## Private asset investment structures

A typical investment structure available to an institutional investor seeking infrastructure exposure is to become a Limited Partner (LP) of a private fund that is managed by a General Partner (GP). In committing £10m to a Fund as an LPs, an institutional investor will be making a commitment to inject up to £10m of capital when called upon by the GP, within a fixed period of time (typically 10 years). While it is legally possible to transfer this Limited Partnership stake to another investor (typically to a Secondaries Fund), arranging transfers is non-trivial.

Limited Partnership Agreements (LPAs) will include the following:

**Mandate:** investment parameters and restrictions, including scale, geography, sector, security type etc.

**Fund Term:** the time horizon for investment and divestment.

**Management Fees:** whether based on capital raised, or assets under management ("AuM"), and payable to the Management Company. Typically annual 2% fee on AuM.

**Distribution Waterfall:** a definition of the economic relationship between GP and LPs, including "carried interest", which is typically 20% of the proceeds after the LP has received distributions equal to the original capital invested plus a defined preferred return.<sup>17</sup>

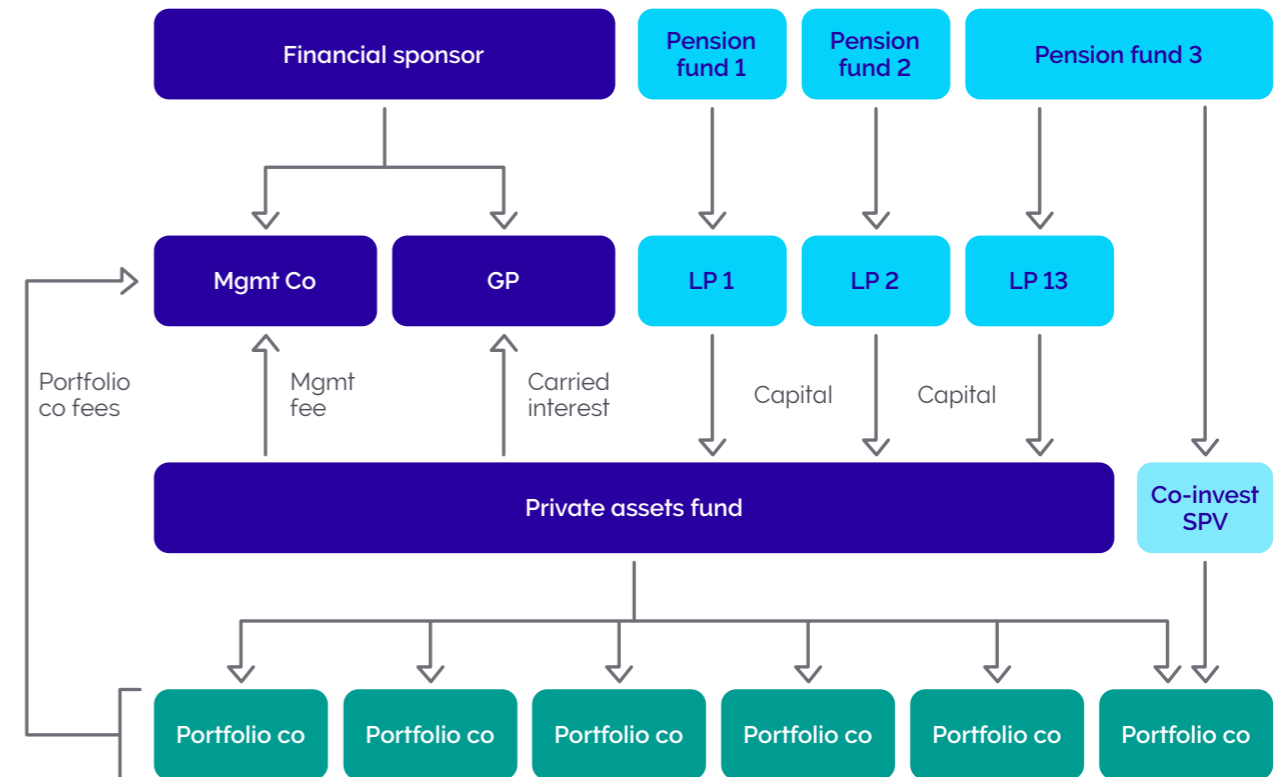
Portfolio companies needn't be wholly owned by a single private assets fund. A fund could take a stake of say 15%, and a seat on the board to inform and oversee company strategy. Often a portfolio company will have multiple PE fund owners. And pension fund LPs will sometimes negotiate the ability to, or will be invited, to **Co-invest** into one or more portfolio companies or projects either directly or through a **Co-investment Special Purpose Vehicle**. Pension funds that are well-resourced can use co-investment to reduce the overall fees paid on their private asset exposures as no management fee or carried interest will typically be payable. They can also serve to

provide better understanding of GPs sourcing and due diligence processes. Co-investment may allow GPs to acquire larger assets, helpful to those pursuing a buy-and-build strategy, and also helpful to retain larger clients without discounting fees.<sup>18</sup>

Other, so-called **Evergreen**, semi-liquid structures exist. These put capital to work immediately and offer regular subscription and redemption periods. Evergreen structures can have semi-permanent investment-horizons which may suit pension funds better than a ten year exit, but can also pose challenges to manage given the mismatch between assets and liabilities. They are common in the Australian institutional market and are increasingly seen in the UK institutional market.

In the US **Business Development Companies** (BDCs) like Ares Capital Corporation, typically investing in the debt of small to medium-sized firms, dominate the landscape with a collective AuM of around \$143bn. There are around \$62bn of closed-end **Interval Funds**, which typically offer quarterly or annual investment/redemption points and invest in other private asset funds. **Non-traded Real Estate Investment Trusts** have close to \$100bn in assets, and are strikingly similar to commercial property funds that have existed for many years in the UK market.<sup>19</sup> There are around €11bn of assets deployed in **European Long-term Investment Funds** (ELTIFs) – vehicles set up to boost investment in illiquids in 2015.<sup>20</sup> And in 2023 the FCA authorised the first **Long-term Asset Fund** (LTAF) in the UK<sup>21</sup>, a vehicle designed to give access for defined contribution pension investors to long-term private market investments.<sup>22</sup>

Example private asset fund structure



### The costs of private assets management

For all of the arguments in favour of private asset investment, gaining cost-effective exposure is difficult. And costs can be sufficient to change the calculus around investing or not investing. While public markets have been successfully disrupted by passive managers who can replicate public market indices at close to zero cost, private markets are different.

Outside of Evergreen fund structures, exposure cannot be easily added or removed to private assets. Commitments can be made to private asset LPAs and expressions of interest in co-investing can be signalled, but investment of funds is lumpy, not entirely in the control of asset owners. It needs careful oversight.

Being unlisted, purchase and sale of each asset needs to be individually negotiated, requiring specialist legal and deals expertise. And assets furthermore need to be actively managed on an ongoing basis. For example, solar farms require upkeep, defaulting private creditors negotiated with and potentially pursued through courts, and private firms may need whole new management teams placed as well as board representatives from their owners.

Providing this level of management requires specialist skills. Commercial asset managers have built these skills in their organisations. But these skills come at a price.

Private assets fees are high, lack transparency, and are unique – because each Limited Partnership Agreement is closely negotiated between GPs and LPs.<sup>23</sup> They are complex to calculate, and include management fees, the cost of subscription lines, monitoring and transaction fees, and several other costs including those attached to consultants, lawyers, as well as addition layers that might arise in fund of fund structures. See exhibit 7.

Furthermore, private asset fund GPs charge carried interest, which will vary according to several variables relating to the ultimate performance of the structure. Carried interest alone is estimated to have generated a cumulative \$1 trillion of fees for the private assets management industry.<sup>24</sup> The difference between net and gross returns of a private capital fund has been estimated to be as high as 6% per annum in one highly cited study.<sup>25</sup>

But if higher fees are the gateway to substantially higher net returns, they can easily be swallowed. However, academic peer-reviewed empirical studies have repeatedly found that the net risk-adjusted returns of public and private assets are comparable.<sup>26</sup> Ludovic Phalippou of Oxford University's Said Business School found in a 2020 study that after fees, investors in private equity funds earn about the same as they would have earned investing in public equity indices since at least 2006.<sup>27</sup> A study published in the Journal of Investing in December 2020 using

clean large institutional client data found that private equity allocations had underperformed public equity by 0.67% per annum in the period 1996- 2018 after fees.<sup>29</sup>

HM Treasury's cost-benefit analysis around the Mansion House Compact was only able to come to its conclusion that allocating 5% to private assets would lift defined contribution pensioner outcomes in a scenario where they halved their estimate of private asset management fees levels. Without halving their fee estimates, they projected that defined contribution pots would be smaller than they would be with a pure public equity market allocation.<sup>30</sup>

And research by CEM Benchmarking, an organisation that works for asset owners with a collective \$15

trillion of assets<sup>31</sup>, found that their clients were on average able to use private assets to build risk-adjusted returns only if they had the scale to manage them in-house. See exhibit 8.

There are clear attractions to investing in private assets for pension funds. But these attractions are meaningfully dependent on the levels of costs accrued in taking investment exposure. Getting implementation right in private markets makes the difference between being a costly drag on member outcomes and enhancing them.

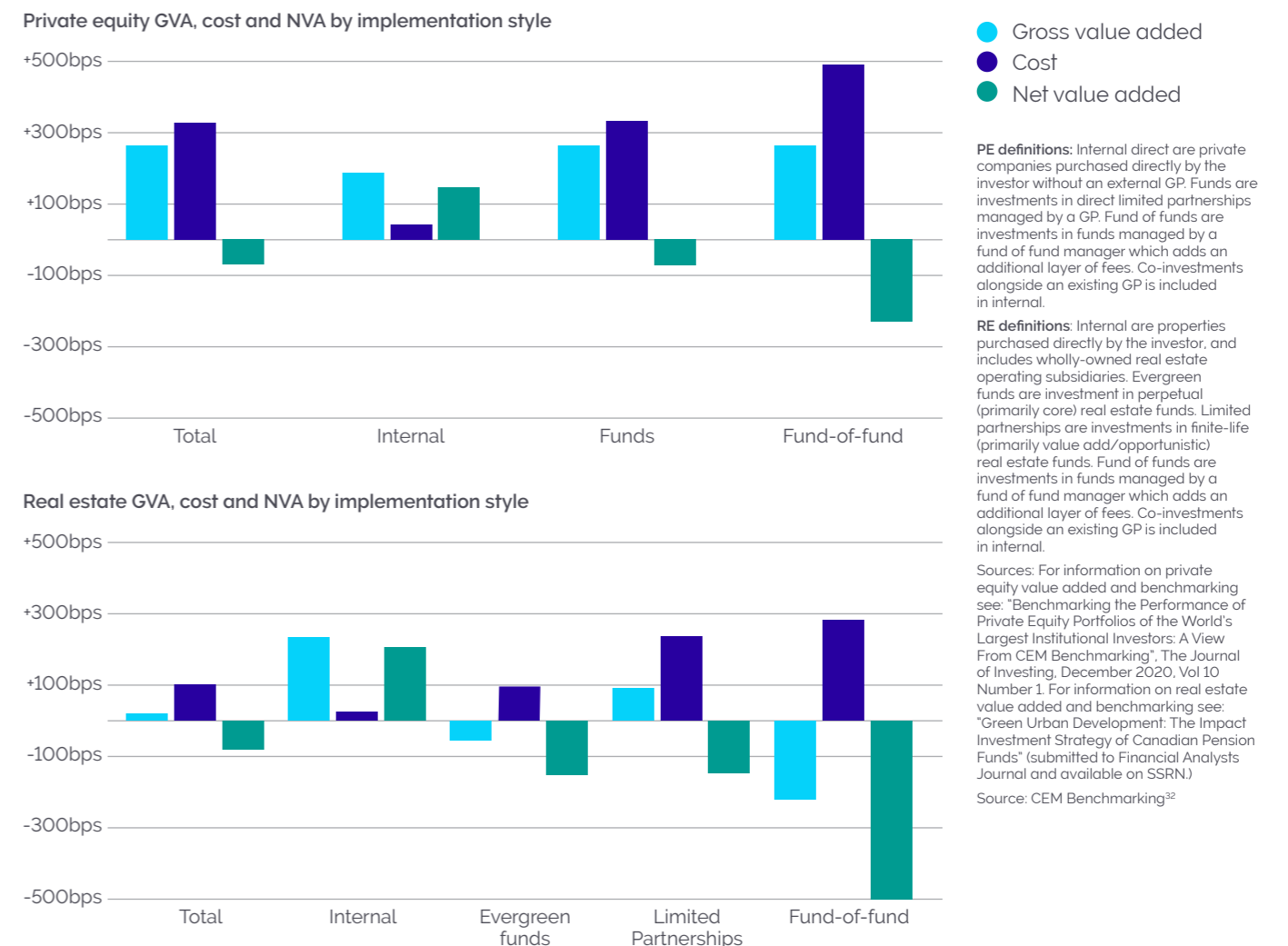
Two pension systems that have made private assets work for them are Canada and Australia. They offer contrasting routes to implementation.

### Exhibit 7: Private equity fees and expenses

	Limited partners	Offsets	Portfolio companies
One time	<ul style="list-style-type: none"> <li>Organisational expenses</li> </ul>	<ul style="list-style-type: none"> <li>Transaction fees</li> <li>Exit fees</li> <li>Break up fees</li> </ul>	<ul style="list-style-type: none"> <li>Deal expenses:</li> <li>Legal</li> <li>Due diligence</li> <li>Consulting</li> <li>Financing</li> </ul>
Annual fixed	<ul style="list-style-type: none"> <li>Audit/tax expenses</li> <li>Fund administration expenses</li> </ul>	<ul style="list-style-type: none"> <li>Monitoring fees</li> <li>Director fees</li> </ul>	
Asset based	<ul style="list-style-type: none"> <li>Management fees</li> </ul>		
Performance		<ul style="list-style-type: none"> <li>Carried interest</li> </ul>	

Source: Stepstone Group.<sup>28</sup>  
 Note: Carried interest is considered an offset because it is paid from proceeds from sales and dividends from portfolio companies. All fees and expenses must be first repaid before the fund pays any carried interest.

### Exhibit 8: Private equity and real estate gross value added, cost and net value added by implementation style





## Notes

- 9 British Business Bank, 2023. UK Venture Capital Financial Returns 2023 Report. <https://www.british-business-bank.co.uk/about/research-and-publications/uk-venture-capital-financial-returns-2023>
- 10 Reported correlation of private equity returns to the S&P600 index of 0.36 rise to 0.76 once lags are removed. See Alexander Beath and Christopher Flynn, 2020. Benchmarking the performance of private equity portfolios of the world's largest institutional investors: a view from CEM Benchmarking. The Journal of Investing, December.
- 11 Cambridge Associates Modified Public Market Equivalent (mPME) provide a private-to-public comparison that seeks to replicate private investment performance under public market conditions. The public index's shares are purchased and sold according to the private fund cash flow schedule, with distributions calculated in the same proportion as the private fund, and the mPME NAV (the value of the shares held by the public equivalent) is a function of mPME cash flows and public index returns. The mPME attempts to evaluate what return would have been earned had the dollars been deployed in the public markets instead of in private investments while avoiding the "negative NAV" issue inherent in some PME methodologies. "Value-Add" shows (in basis points) the difference between the actual private investment return and the mPME calculated return.
- 12 Marks, Howard. You Can't Eat IRR. Available at <https://www.oaktreecapital.com/docs/default-source/memos/2006-07-12-you-cant-eat-irr.pdf>
- 13 See Phalippou, Ludovic, The Hazards of Using IRR to Measure Performance: The Case of Private Equity. Available at SSRN: <https://ssrn.com/abstract-1111796> or <http://dx.doi.org/10.2139/ssrn.1111796>
- 14 <https://www.blackrock.com/institutions/en-us/literature/market-commentary/private-debt-primer-oct-2023.pdf>
- 15 <https://www.hamiltonlane.com/en-us/insight/private-markets-a-guide>
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# International success in allocating to private markets

## Canadian pension allocation to private assets: the internal route

Canadian pension allocations to private assets are substantial, and returns are strong. But they need to be set in the context of the Canadian pension landscape.

Almost half of the country's pension assets are concentrated in a very small number of large public sector pension funds – the so-called Maple 8. These are public-sector pension funds mostly investing to meet defined benefit pension promises made to public sector workers. The exception is Canadian Pension Plan, an intergenerational buffer fund aiming to smooth the burden of an increasing dependency ratio caused by demographic change by pre-funding the state pension by investing mandatory pension contributions made by Canadian workers. Most, but not all, are crown corporations – owned by the Canadian government to serve a mixture of commercial and public policy objectives and accountable to the government.<sup>33</sup> See exhibit 9.

The creation of a Task Force on the Investment of Public Sector Pension Funds resulted in the creation of the Ontario Teachers Pension Plan (OTPP) in 1990, replacing the Teachers Superannuation Fund – a government bureaucracy with all assets "invested" in non-marketable Ontario bonds. It was staffed with private sector executives, swapped its C\$20bn non-marketable assets for market assets and began to build internal investment capabilities quickly, especially in private assets. OTPP's structure and approach was copied in the creation of the Canada Pension Plan Investment Board, as well as by other public sector Canadian pension plans and has come to be known as the 'Canadian Model'.<sup>34</sup>

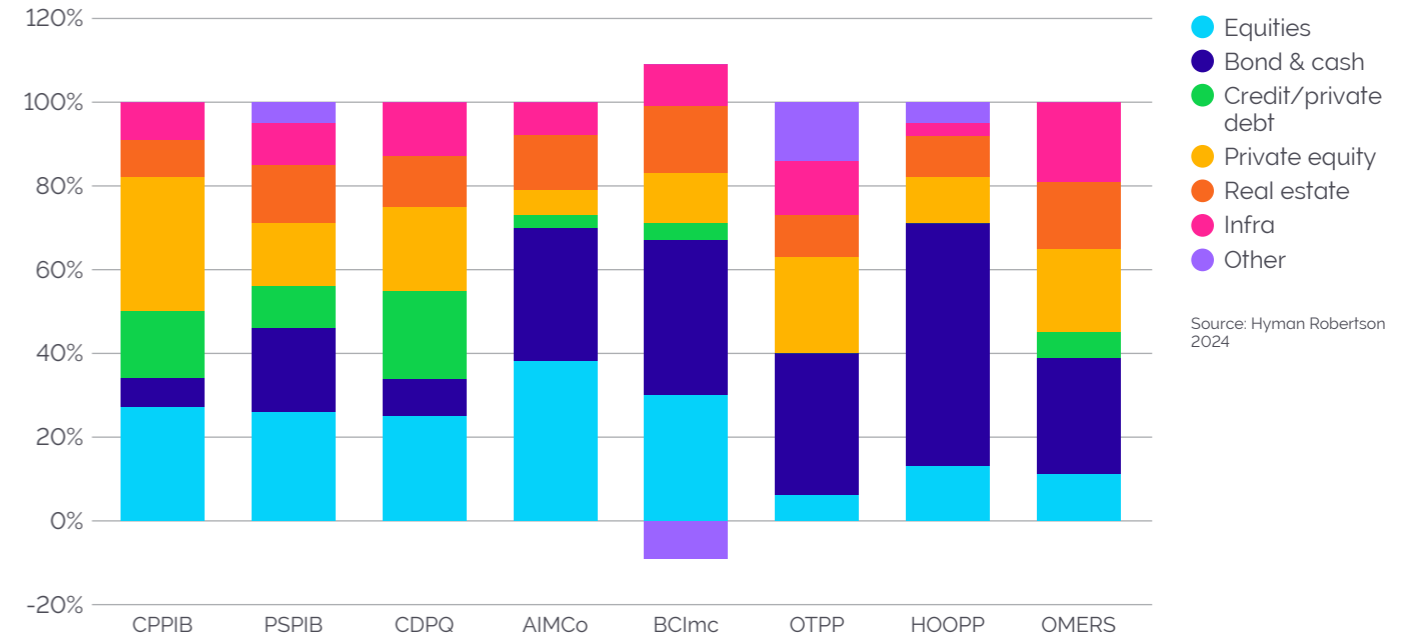
The 'Canadian Model' integrates independent governance, professional well-paid in-house investment management, substantial scale, and comprehensive geographic and asset-class diversification with high allocations to unlisted assets as a model that might be emulated by others.<sup>35</sup>

## Exhibit 9: Overview of the 'Maple 8' – major Canadian public pension funds

Pension Plan	Code	Est	Sponsor	Type	Crown Corp	AuM
Canada Pension Plan Investment Board	CPPIB	1997	Federal & Provincial Governments	Federal	Y	£362bn
Public Sector Pension Investment Board	PSPIB	2000	Govt of Canada	Federal	Y	£152bn
Caisse de depot et placement du Quebec	CDPQ	Provincial	Govt of Quebec	Provincial	Y	£249bn
Alberta Investment Management Corporation	AIMCo	2008	Govt of Alberta	Provincial	Y	£92bn
British Columbia Investment Management Corporation	BCImc	1999	Govt of British Columbia	Provincial	Y	£143bn
Ontario Teachers' Pension Plan	OTPP	1990	Govt of Ontario & Ontario Teachers Federation	Occupational	N	£143bn
Healthcare of Ontario Pension Plan	HOOP	1960	Ontario Hospital Association & Unions	Occupational	N	£65bn
Ontario Municipal Employees Retirement System	OMERS	1962	Various govt entities & four unions in Ontario	Occupational	N	£74bn

Source: Hyman Robertson<sup>36</sup> and van Gelderen<sup>37</sup>

## Exhibit 10: Strategic asset allocations of Canadian Maple 8 funds, £ billion, 2023



Source: Hyman Robertson 2024

Allocations to infrastructure, real estate, private equity vary between around a quarter of assets to somewhat over half of assets. In aggregate these allocations make up over 40% of total Maple 8 assets. See exhibit 10.

Strong total returns from the Maple 8 have bolstered calls to raise private asset allocations in UK pensions.

But while the British pension system eclipse the Canadian system by size, it is also characterised by extreme fragmentation. Only one UK pension fund makes it into the top one hundred global pension funds, ranked by assets.<sup>38</sup> Canada by contrast has eight such funds, Australia seven, Denmark, Sweden and Finland three apiece, Mexico four. Japan and the Netherlands have five.<sup>39</sup>

The high level of fragmentation keeps UK pension funds individually on the smaller side, and when it comes to private assets this lack of scale has significant consequences for net returns.

## Scale

Overseeing very large asset pools changes the economics of investing in private assets. As shown in section 1, an empirical study by CEM Benchmarking found that clients with an internal private equity capability enjoyed lower gross returns than clients who allocated to external private equity funds or external private equity fund of funds. This gross performance advantage was more than entirely captured by external managers in the form of higher fees: the internally managed allocations outperformed externally managed funds by over 2% per annum net of fees.<sup>40</sup> Internal allocations to real estate were found to have similarly outperformed externally managed allocations net of fees.

CEM Benchmarking found internalisation of asset management to be a significant predictor of excess returns. Putting some numbers to this, they found that 100% internally managed portfolio consisting of public and private assets is expected to produce an incremental 19 bps of net value added relative to a 100% externally managed portfolio. And that the benefits of internalisation are due mainly attributable to the private assets where cost savings are measured in the hundreds of basis points. See exhibit 11.

The CEM Benchmarking study pointed to benefits from internalising private assets beyond only investment costs. Given the significant use of leverage in private equity and real estate, the study observed that Maple 8 funds would likely benefit from lower cost of debt than many private assets management fund vehicles and portfolio companies on account of their size and asset wealth. A lower cost of debt contributes to superior net of fees returns versus external management, though it is not easy to estimate the size of the contribution.

But significant scale is required to be able to make the economics of internal private market management work. In 2020 the smallest investor who reported substantial internal private equity investments had \$18 billion in total assets. The average investor reporting large internally-managed private equity investments had assets of \$152 billion.<sup>41</sup>

The Norwegian Government Pension Fund – Global (NBIM) has been able to build an internal direct infrastructure capability from scratch, at a very low cost. But their experience may not be easily replicable. The cost of internally managing their €1.3bn of infrastructure assets came to only €3.4m in 2022 – or 28bps of asset value.<sup>42</sup> But NBIM had

cumulatively originated only a single asset at that time in the form of a 50% stake in the Borssele 1 & 2 offshore wind farm, operated by, and co-owned with, Ørsted.<sup>43</sup> With US\$1.7tn in total fund value, this allocation did not represent the kind of unacceptable concentration risk that it would present to a smaller fund.

Total system-wide assets managed by the fastest-growing part of the UK pension system – defined contribution MasterTrusts – came to £169bn at the end of 2023, with only four MasterTrusts exceeding the asset base of the smallest investor in the CEM Benchmarking study.<sup>44</sup> The economics of building large and highly-paid teams to manage internal allocations of private assets looks challenging for most individual UK pension schemes.

But the government's plan to require MasterTrusts and Group Personal Pension providers to manage a minimum of £25 billion of assets in their default plans by 2030 would see the landscape transformed. Only firms capable of internal management would – under the proposal – remain.

The experience of Canadian pension plans holds lessons to UK funds around governance, set up and offers a glimpse of the synergies that come with scale. But their very scale makes some lessons less relevant for UK smaller schemes today.

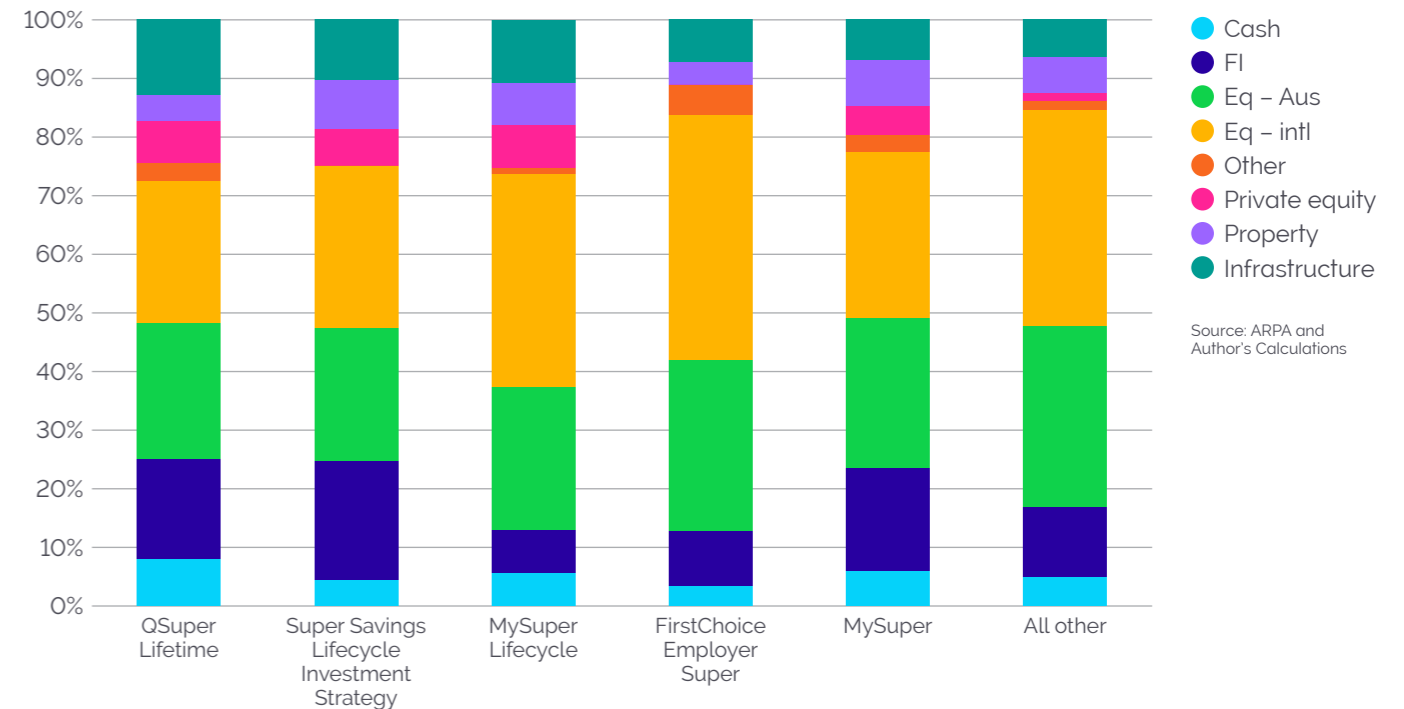
Australia's defined contribution pension super funds are closer cousins to UK MasterFunds. While still substantial, their size and regulation is closer to UK system. Moreover, they exist in a competitive landscape of DC providers between whom pension members can switch assets. For these reasons, the routes by which Australian super funds have taken private market exposures is instructive.

**Exhibit 11:**  
Average annual private equity returns net of expenses 1996-2018, by implementation category

	Gross return	Implementation costs	Net returns	BM returns	Net value add	# of observations
Fund of funds	13.6%	4.9%	8.7%	11.0%	-2.3%	2,200
Limited partner	13.7%	3.3%	10.4%	11.1%	-0.7%	1,400
Insourced	12.4%	0.4%	12.0%	10.5%	+1.5%	300

Source: Ambachtsheer 2021<sup>45</sup>

**Exhibit 12:**  
Strategic asset allocations of Australian Super Lifecycle funds, £ billion, Q1 2024



Source: ARPA and Author's Calculations

**Australian collectivism**

Pensions in Australia are closely tied to the organised labour movement and a collective mindset.

The impetus for a contributory superannuation system came primarily from the organised labour movement in the 1970s, who saw pensions as a way in which deferred wage increases could boost lifetime worker incomes without breaking the country's centralised wage fixing framework.<sup>46</sup> By 1985, the government supported the establishment of 'industry' superannuation funds – not-for-profit mutual structures established by the trade unions – to settle wage demands while also controlling inflation and improving national saving.

From 1992 the 'Superannuation Guarantee' compelled employers to make contributions to pension funds, and since that time contribution rates have steadily increased from 3% to 11.5% of eligible earnings, and is due to step-up to 12% in July 2025.<sup>47</sup> The result is a A\$3.9tn pension system, A\$2.7tn of which are in ARPA-regulated assets and looks similar in structure to the UK's defined contribution pension system.<sup>48</sup>

Allocations to private assets by Australian Super funds are substantially higher than they are by UK DC MasterTrusts, with a skew to infrastructure investment. Around A\$400 billion of Super Funds are managed in the form of default Lifecycle products, and the largest five of these account for 72% of the market. Allocation to unlisted assets averages 21% across lifecycle funds, with allocations by the largest five default lifecycle products ranging between a tenth and a quarter. Infrastructure investment makes up almost half of these private asset investments.<sup>49</sup> See exhibit 12.

The high level of investment in infrastructure follows a deliberate choice made early in the set-up of the Australian system. Having been born out of the Australian labour movement, DC industry funds started with a strong collective investment mindset, a desire to increase investment in the economy, and capture the illiquidity of private assets for members. This led labour unions to found new sector-aligned private assets managers, in part to disrupt the prevailing norms in the investment management industry, delivering high quality service at a low cost.



In 1990 the Australian Council of Trade Unions (ACTU), The Australian Chamber of Manufacturers (ACM) and AMP (a large mutual life assurance company) came together with four industry funds to create the Development Australia Fund (DAF), now Industry Funds Management Investors, or IFM Investors. And in 1994 Industry Super Property Trust (ISPT), a trustee company started by four industry funds, was founded on a similar collective investment model.

IFM was created to be a for-profit infrastructure investment manager owned by super funds. It was explicitly designed to support national projects seen as nationally and economically important.<sup>50</sup> The Australian government was in the midst of privatising national assets, and trade unions saw a strategic opportunity for workers to benefit from these cheap asset sales. And the profits it made from managing infrastructure investment would be reinvested in the business or flow to industry super fund members. Today it is one of the largest five infrastructure managers in the world with £65bn of assets, and has expanded beyond strategic infrastructure investments in the Australian economy to build international exposures – including a variety of UK assets such as stakes in the M6 toll road and Anglian Water. It has also expanded from pure infrastructure investment and now also originates and manages private equity, listed equity and private credit. And it works for a global client base, although continues to be owned by 17 Australian pension funds. It manages closed-end funds, but the bulk of assets are invested in evergreen funds that are characterised by long-term, almost permanent, investment horizons.<sup>51</sup>

ISPT, by contrast, was set up to operate on a cost-recovery basis – identifying possible real estate investments for super funds who would then make investment decisions.<sup>52</sup> This model provided less independence to firm management, and allowed supers to retain control of all allocations, harbouring different principal-agent dynamics. As the number of ISPT pension fund clients grew, so its operating model changed. Today it manages A\$20bn for 28 super funds, \$17bn of which is held in a single evergreen fund.<sup>53</sup> The board continues to have seats reserved for founding industry funds, but has also expanded to bring in independent non-executives. In recent years there has been increasing speculation that IFM and ISPT will merge to create a A\$240bn real assets manager.<sup>54</sup>

Today most private assets in the Australian pension are managed by private sector managers rather than these sector-aligned private assets managers. But these sector-aligned managers have grown significantly from their origins, and their impact in enhancing competition and reducing private sector fee rates across the industry fees is perhaps as important as the direct management of assets.

Indeed, in a review of the costs that eleven Australian super funds ran that stripped out effects of scale (by benchmarking each super fund to a universe of similarly-sized global-ex-Australia funds), CEM Benchmarking found that super funds had a notably lower cost structure than peer funds. The investment costs (including external and internal management, governance, custody etc) averaged 43.6bps versus a like-for-like benchmark cost of 55.3bps, despite less use of internal management. This may sound small, but it works out at an annual saving of over A\$1 billion in costs on a system-wide basis. The primary driver – accounting for 8.4bps of the total 11.7bps cost reduction – comes from lower external manager fees, particularly in infrastructure and real estate.<sup>55</sup> Around 83% of real estate and 70% of infrastructure are invested in evergreen/core funds rather than through more costly LP structures; this more than offsets the higher cost of having a lower proportion of asset managed internally versus global peers.

**Exhibit 13:**  
**Average base manager fees for externally, actively managed programmes in the CEM database (basis points)**

	Australia	Global
Emerging stock	52.6	56.3
Global stock	31.1	38.5
Real estate (evergreen/core)	46.9	75.4
Infrastructure (evergreen/core)	46.1	70.4

Source: Heale & Saaim, 2024<sup>56</sup>

The Australian experience is instructive in showing that pension funds can work collaboratively to change the economics of private markets investment management. This was achieved only through deliberative action, with pension funds and their union sponsors identifying that individually they lacked scale to make the economics of internal management work – but by pooling resources they could secure better outcomes for their members.

So while Canadian pension schemes have made the economics of private market investment work through sheer dint of their scale and concentration. Australian schemes have made the private markets investment work by coming together to change the economics of the commercial investment management landscape.



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# Making private market work for UK pension members



Government is motivated to increase UK pension allocations to areas like venture capital, growth equity and infrastructure with economic goals in mind, and has a variety of regulatory and legislative tools to achieve this goal.

Moreover, there is a case for pension funds to build exposure to private markets for their members if it can be done in a way that is additive to returns, net of fees. This has been achieved in both Canadian and Australian pension systems by changing the economics of private market investing.

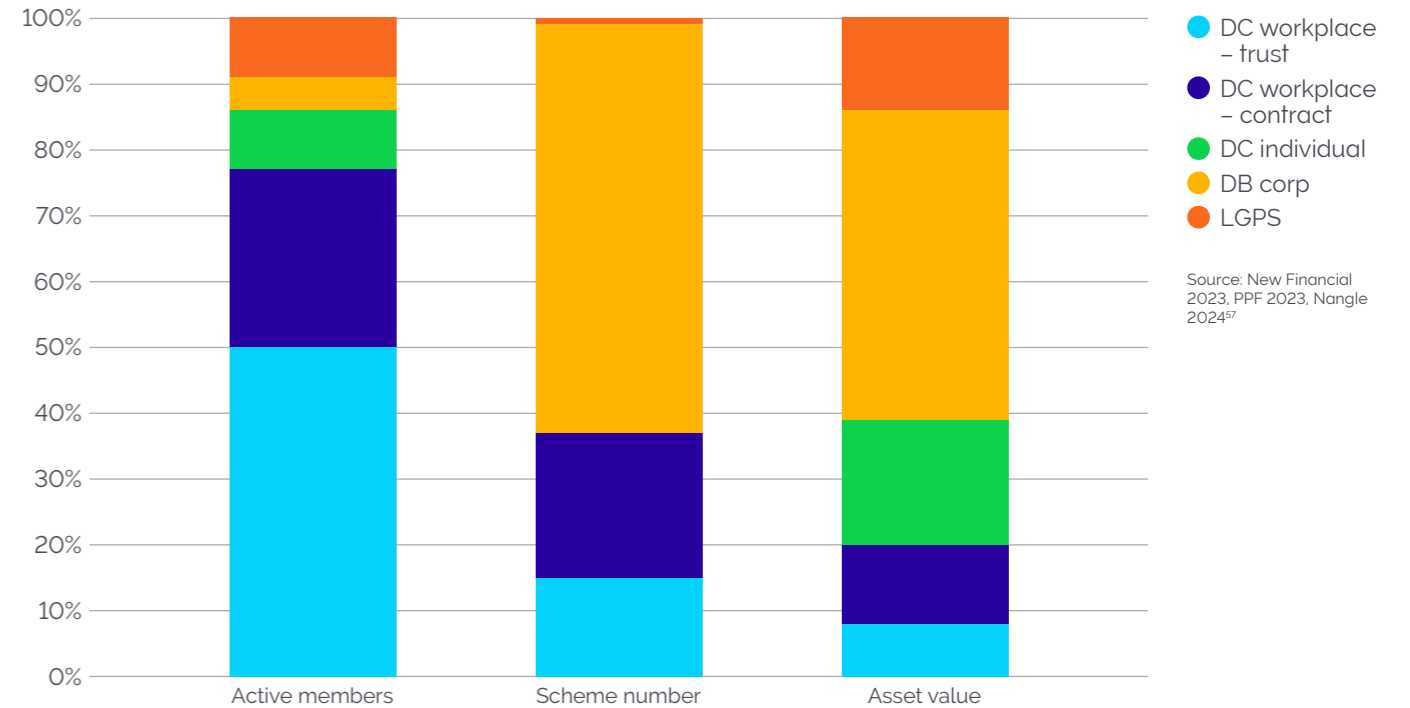
Understanding the landscape of a country's second pillar pension system is critical to understanding how private market asset investment can work for members, if at all.

The funded UK pensions system has enormous scale, but is highly fragmented. Leaving aside the 27,000 micro defined contribution schemes, it contains over eight thousand schemes representing twenty-five million members.

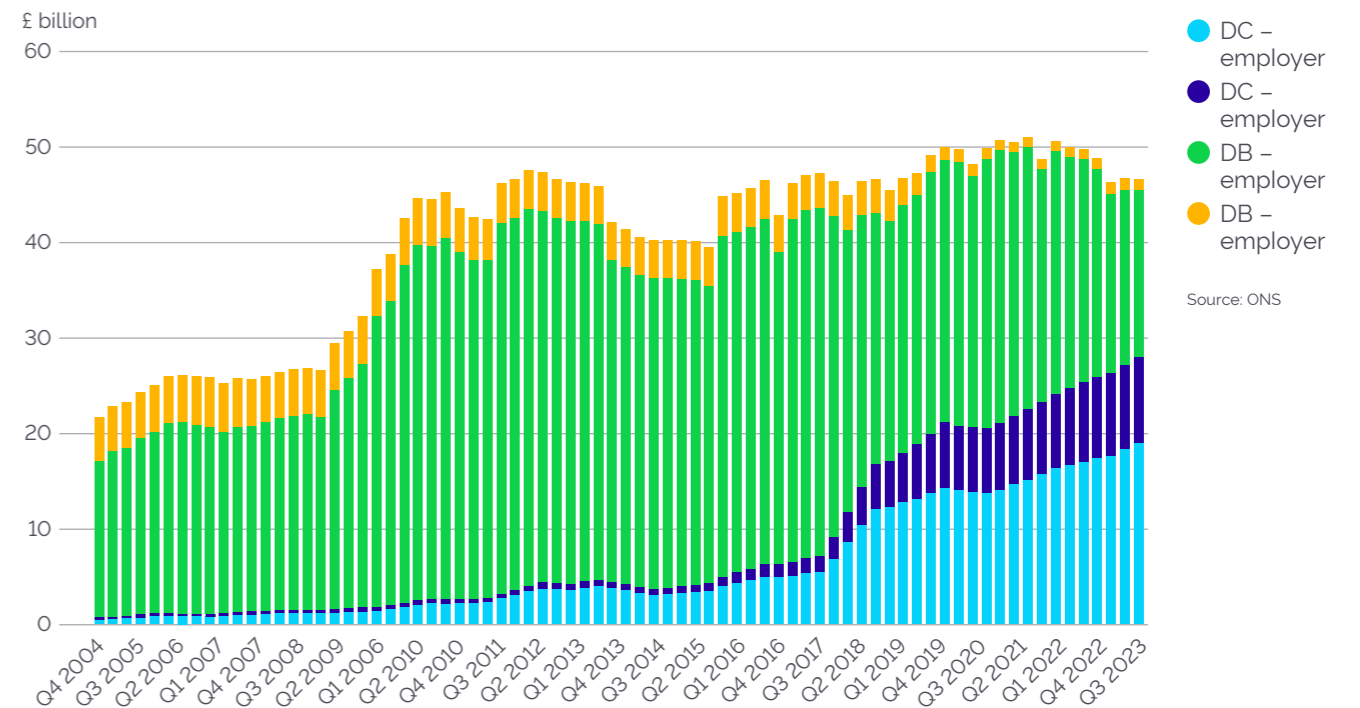
Private sector defined benefit schemes represent most funded assets. They are largely closed to new members, and often to future accrual, are in funding surplus, and are essentially in run-off. Their liabilities are increasingly bond-like, and so too are their assets. There is a role for growth-oriented private market assets in those few private sector defined benefit pension funds that remain open. And there is a role for long-duration inflation-linked cashflows that are common to some types of infrastructure and real estate in those schemes choosing to run on rather than buy-out. See exhibit 14.

But despite their smaller asset base, the future of pensions investment in the UK sits largely with defined contribution pensions. Contributions to DC schemes now eclipse those made to DB schemes – and within DC, Master Trusts dominate. See exhibit 15.

**Exhibit 14:**  
The UK pension system – large but fragmented



**Exhibit 15:**  
Quarterly contributions to UK pension schemes, 4Q rolling 2003-2023





DC Master Trusts (a type of trust based occupational pension scheme in which multiple employers can participate) account for 95% of active DC pension membership.<sup>58</sup> Today the top five Master Trusts account for £114 billion of the total £169 billion of assets managed by Master Trusts.<sup>59</sup> But the DWP projects that 83% of members will have an estimated £300 billion of assets managed in one of the largest five Master Trusts by 2030, out of a collective £420 billion overseen by Master Trusts in their central estimate.<sup>60</sup> The landscape is rapidly consolidating, but it is likely that there will still be a dozen or so Master Trusts a decade from now. In November 2024 the DWP consulted on whether there should be a minimum asset size for DC default funds of £25 billion.<sup>61</sup> If such a minimum is mandated it would be consistent with an even more radical consolidation. See exhibit 16.

Some Master Trusts have already made the decision to commit to private market assets as part of their default fund asset allocation. Several became

signatories of the Mansion House Compact in summer 2023 in which they committed to increase allocations to unlisted equity to 5% of default fund NAV.<sup>62</sup>

Others have noted the reams of academic and industry empirical studies that record the negative impact that external manager fees have on member total returns.

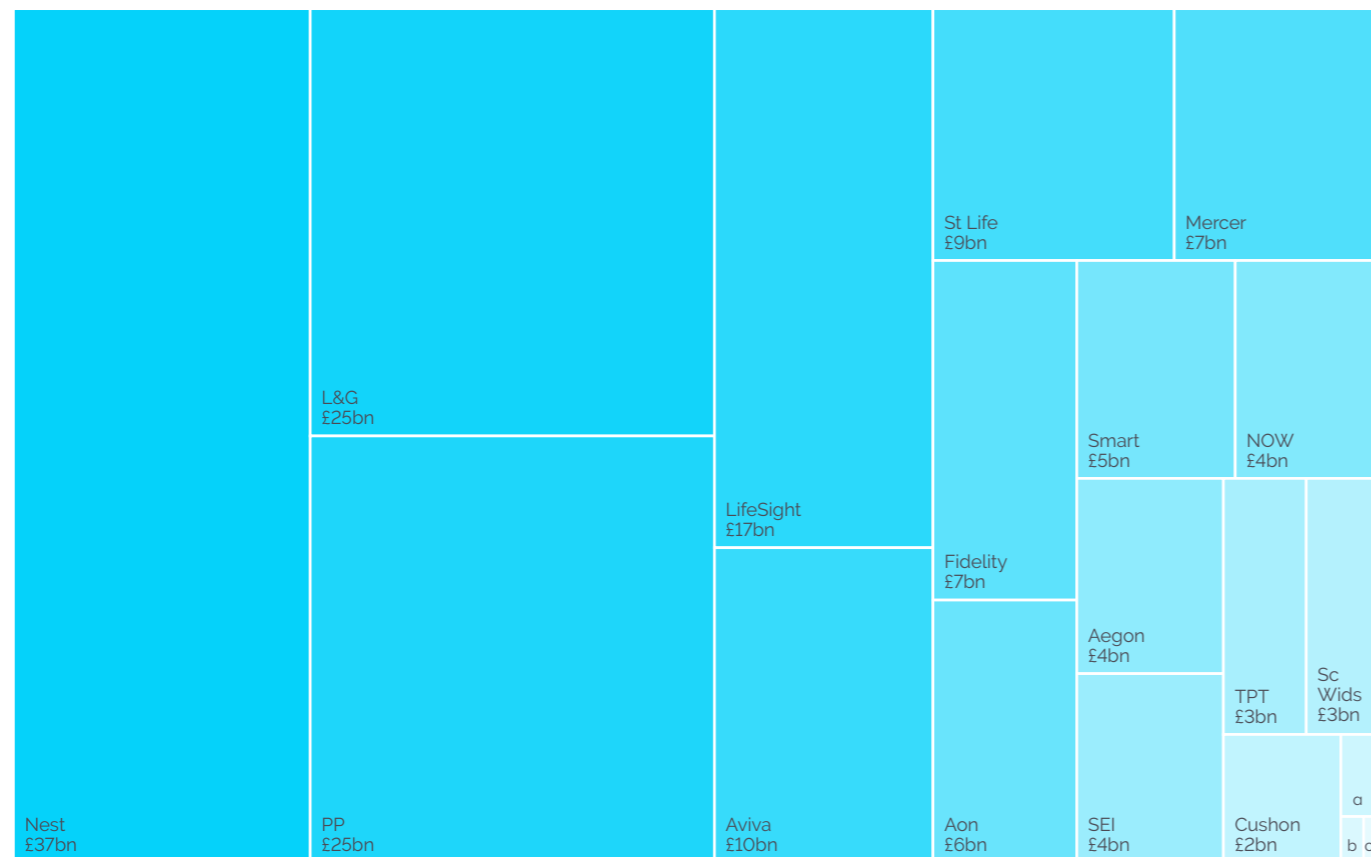
Granted, there are non-economic reasons to add to private markets. For example, recent research points towards the potential benefits in terms of member engagement of integrating private market assets in areas like clean energy and affordable housings.<sup>63</sup> But the same research highlights overwhelming concern around the potential for weaker returns also.

So while non-economic member-driven reasons to add private markets exist, these don't eclipse the imperative to deliver strong investment returns.

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- 63 ABI 2024. The Mansion House Compact: Year one progress update. <https://www.abi.org.uk/globalassets/files/publications/public/lts/2024/abi-mansion-house-compact.pdf>
- 64 L&G, 2024. Private markets can help support greater pensions engagement among DC members. September. <https://group.legalandgeneral.com/en/newsroom/press-releases/private-markets-can-help-support-greater-pensions-engagement-among-dc-members>

**Exhibit 16:**  
UK Master Trust assets under management, December 2023



Source: Go Group, February 2024<sup>64</sup>

a = Options £0bn b = Cheviot £0bn c = Lewis £0bn





# Economies of scale and internal management

There are a range of implementation forms that pension funds can take to access private market assets. To get a sense of the costs attached to each we can look CEM Benchmarking data relating to a population of 294 institutional investors with an average \$29 billion of assets.

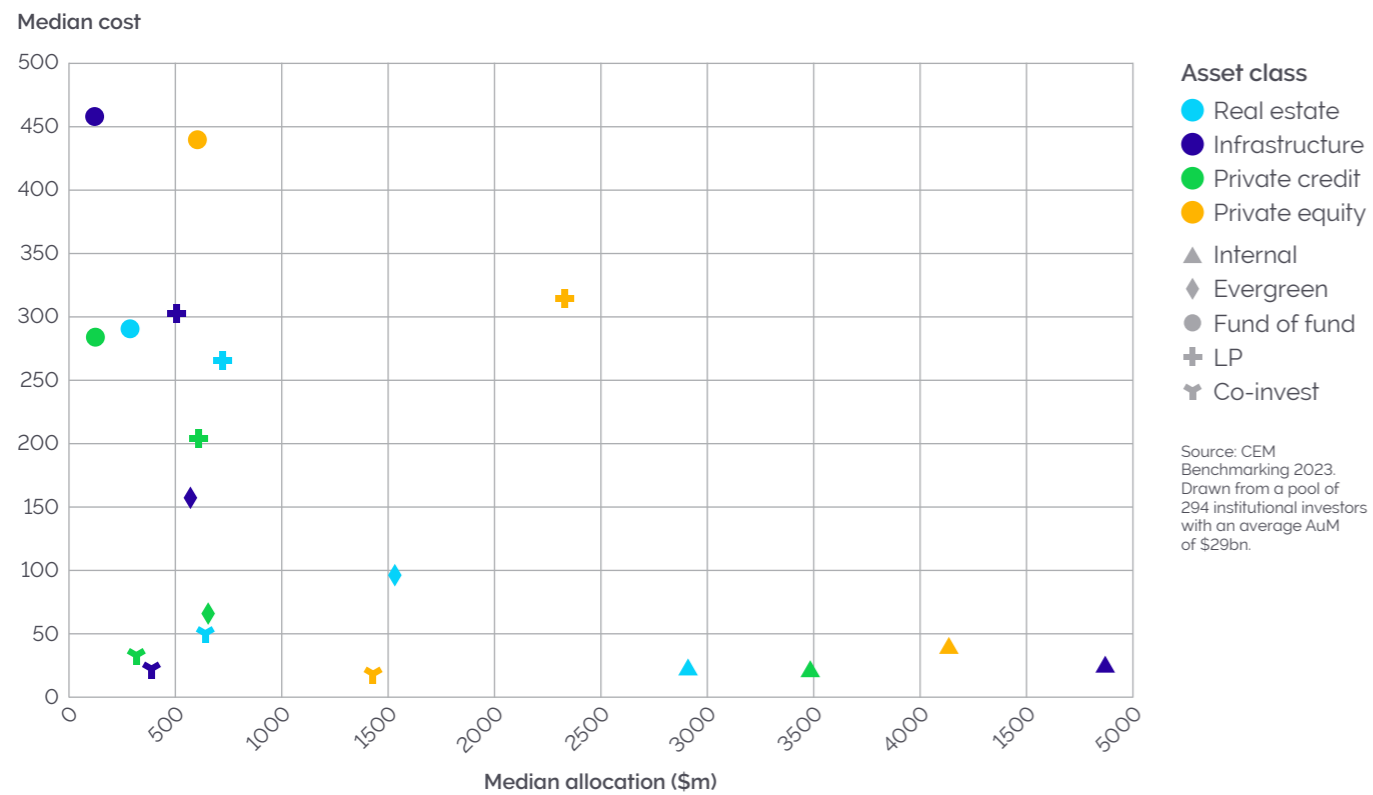
Exhibit 17 summarises key data by private market asset class and form of implementation. Broadly speaking, internal management is the cheapest form of implementation, but it requires scale. Fewer than a fifth of this group of large investors had one or more internal management capabilities.

The median costs of internal management (Exhibit 17, triangle-shapes) varied by private market asset class from between 20bps to 40bps. But these low costs were associated with median allocations to internal real estate, infrastructure, private credit and private equity teams of \$2.9bn, \$4.9bn, \$3.5bn and \$4.1bn respectively.

Cost savings for members are based on the expectation that internally-managed assets will deliver comparable gross returns achieved by highly-paid professional experts operating with significant institutional infrastructure and resources.

To get a sense of the scale of personnel resources required, we can turn to the experience that USS has had in growing their private markets team. To manage £5.5 billion of private equity funds, they require an internal team of only three people. To manage £4 billion of real estate assets they employ an internal team of twelve. £8.5 billion of private credit requires an internal team of twenty. And £8 billion of infrastructure needs a team of twenty-seven. Beyond these teams are four private market strategists and six business managers.

**Exhibit 17:**  
Large institutional investors' implementation of private market asset investment



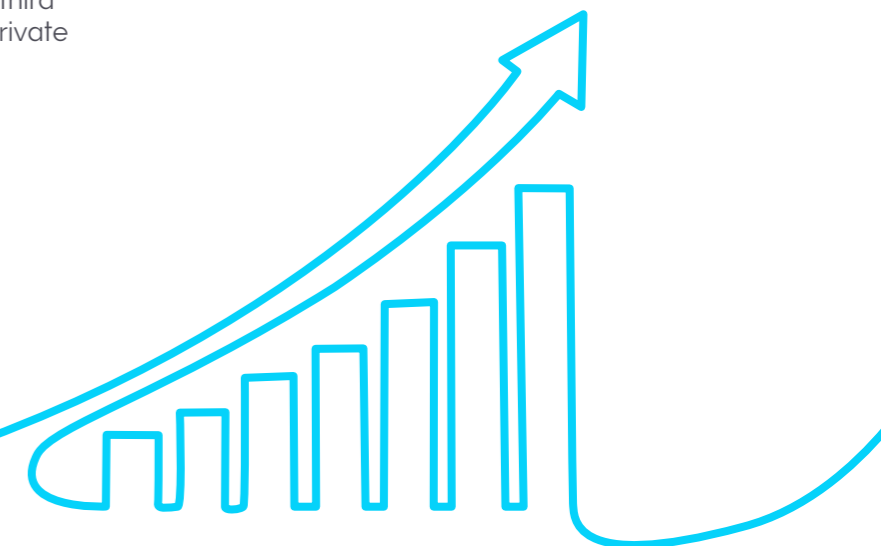
**Exhibit 18:**  
USS Private Markets Group resourcing and assets, by investment team

	Property & credit		Equity			
	Property	Private credit	Infrastructure	PE funds	Private market strategy	Business management
Team staff	12	20	27	3	4	6
AuM £bn	4.0	8.5	8.0	5.5		

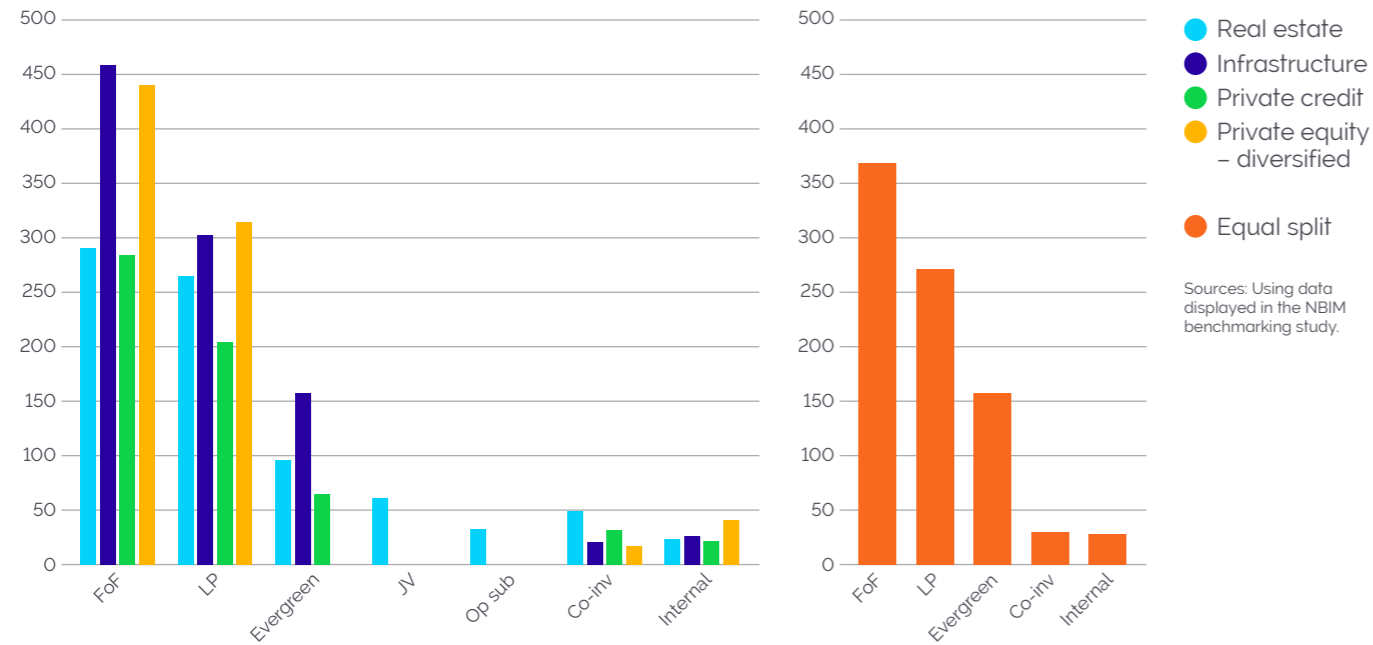
Employing a full-time internal investment team of seventy-two people to manage private market assets is a substantial commitment. It makes sense for USS in the context of their £27 billion allocation, but such a personnel and resource commitment would not likely make sense for any other single UK pension fund today. See exhibit 18.

At the other end of the spectrum it is possible to completely outsource management of private market assets through a fund of funds structure. The cost of managing an equal split of real estate, infrastructure private credit and private equity – including performance fees – for the median institutional investor in their database using a fund of funds approach (Exhibit 17, circle-shapes) came to 368bps per annum in 2022. In such a structure, the fund of funds manager select and manage commitments to LPs, co-investment structures, and Evergreen funds. Costs for pure real estate or private credit fund of funds were on the lower end, at 290bps and 284bps respectively, while infrastructure and private equity fund of funds were at the higher end at a median cost of 458bps and 440bps respectively. Over a third of institutions in the database had exposure to private equity fund of funds, with a median allocation to private market fund of funds of over \$600m.

Having an internal team to select and manage Limited Partnerships is more internal resource-intensive than allocating to a private asset fund of fund manager, but doing so reduces the cost of implementation for large investors. The median costs of investing via LPs (Exhibit 17, cross-shapes) is between 200-300bps per annum depending on the asset class. Private equity costs are on the high end, with median costs just over 300bps per annum – and this is in the context of the median institutional investor in the study allocating almost \$2.5 billion to this area. Evergreen funds (Exhibit 17, diamond-shapes) are typically lower cost for private credit (65bps), infrastructure (157bps) and real estate assets (96bps), but tend not to feature in the institutional private equity world and so are absent from the CEM Benchmarking universe.



**Exhibit 19:**  
Median costs of investing in private markets for a universe of 294 large institutional investors with average total assets under management of \$29 billion, 2023.



The lowest cost form of external implementation is through co-investment structures. Co-investments are direct stakes in transactions (infrastructure assets, portfolio companies etc). These are taken by LPs outside the main private fund, typically through a separately structured co-investment vehicle. Such vehicles tend to be governed by separate agreements in which GPs will retain operational oversight of the underlying asset but will not charge either management fees or accrue carried interest – reducing the management costs for the LP to levels more in line with those of direct internal management. Beyond cost advantages, co-investments can give LPs access to enhanced due diligence materials than would otherwise be available, and can be used to build internal skills – not only in investment decisioning and monitoring, but legal, compliance, reporting, operations and the machinery of internal governance.<sup>65</sup>

Delivering a successful co-investment programme requires skill. External General Partner managers are in total control of which co-investment deals are offered, to whom, and in what size. These might include deals that GPs lack the capacity to fund through the fund they manage, projects which fall outside the risk tolerance of the fund, deals with new partners that lack a strong track record, or indeed

deals that they think are superb and will build LP client loyalty. Pension fund clients need to be able to discriminate between deals, and to build a very diversified portfolio.

But importantly, co-investment opportunities tend to be offered only to LPs – and as such they can be understood, in part, as a way for external private asset managers to offer fee sweeteners to clients who are paying full-fees. There are examples of managed co-investment funds without carry – to provide GPs with greater acquisition firepower for funds in which they accrue carried interest – but these are relatively new. Co-investing tends not to be a solution to high external costs, though it does ameliorate them. In the CEM Benchmarking database 15% of institutional investors had an exposure to private equity co-investments, and the median allocation to a PE co-investment programme was \$1.4 billion. This compares to 55% of institutional investors with exposure to private equity Limited Partnerships and a median allocation of \$2.3 billion.

Costs aside, the optimal private assets implementation model will depend upon a pension fund's investment philosophy and process.

Private markets require firm commitments of capital stretching over many years. This reduces the flexibility to allocate to, or away from, a particular private market on a tactical basis, even under most forms of external management. But where assets are managed internally, there can be substantial organisational frictions attached to any asset allocation decision. Pension funds that build internal investment teams offer these teams a single client. This strips the internal team of any costs (in time as well as money) of sales and marketing. But it also introduces serious conflicts of interest into the capital allocation process. Cutting allocations below an organisationally-specific threshold will make the choice of internal management economically unviable. And reducing allocations towards this level could cause organisational uncertainty, and associated staff turnover. As such, pension funds considering insource management of private assets will need to test the compatibility of making a strategic allocation to each private markets area against their investment philosophy and process.

### Notes

<sup>65</sup> Norton rose Fulbright, 2020. Private equity funds and co-investment: A symbiotic relationship. <https://www.nortonrosefulbright.com/en/knowledge/publications/12c81c8a/private-equity-funds-and-co-investment#:~:text=Broadly%2C%20a%20co%2Dinvestment%20is,a%20separate%20set%20of%20agreements>





# Estimated costings to manage Master Trust private market assets

Cost should not be confused with value. Lower implementation costs do not necessarily deliver higher net returns. But such are the fees in externally-managed private market asset management that it is not responsible to be fee-agnostic when it comes to implementation.

The costings attached to different forms of private market implementation for a given institution will vary wildly. Included in the cost calculus will be many factors such as the general type of private market exposure desired, the specific form of that general private market exposures, whether economies of scale are available to the investor, the private market landscape at the time of investment, and the speed at which investment exposure is required. It would be imprudent to attach too much credence to sweeping estimates. But it is possible nonetheless to use available peer data to arrive at a thumbnail sketch of costs.

The Department of Work and Pensions' central estimate of total defined contribution Master Trust assets in 2030 comes to £420 billion, with higher and lower bound estimates for this asset base of £480 billion and £360 billion respectively. If we assume an average allocation to private markets of 10% this represents a cost-bearing asset base of £36-48 billion. Splitting the allocation associated with the DWP's central estimate into four equal parts allows

us to estimate the costs of management using the CEM Benchmarking dataset.

Median internal costs from the dataset are taken for each of the four categories of private market – disregarding the potential that, for example, global large asset owners may overwhelmingly concentrate their infrastructure investment in lower cost Core Infrastructure and Master Trusts may desire allocations to higher cost Value Add or Opportunistic infrastructure. And median costs are taken for Evergreen real estate, infrastructure and private credit funds – which have the highest median allocations across large asset owners and are the lowest cost route for external management implementation in the dataset, leaving aside the co-investment route.

We assume that Master Trusts' exposure to private credit, property, and infrastructure is almost entirely internally managed, with only a tenth being allocated to external Evergreen funds. For private equity we assume that half of their exposure is managed internally, and half flows taken through external funds. Furthermore, we assume that two-thirds of the external private equity allocation is taken through LPs, and the remainder is taken through very low-cost co-investment routes. In aggregate this leaves 80% of Master Trust private market assets managed internally, and 20% managed externally.

For all external private market funds, median costs are taken from the CEM Benchmarking survey of large asset owners. The total cost, using the assumption that 10% of the DWP's central estimate and all of the aforementioned cost estimates and implementation formats, comes to £235 million per annum, or 5.6 basis points of total Master Trust assets.

Creating an internal multi-strategy private market investment function capable of delivering strong investment returns for Master Trusts' entire allocation to private market assets, at a cost in line with global peer funds, would take costs far below the blended assumption outlined above. The CEM Benchmarking survey data suggests that costs would be almost exactly half those outlined in the blended example above at £117 million per annum, or 2.8 basis points of total Master Trust assets. See exhibit 20.

Changing assumptions around the proportion of assets invested in private markets, the proportion managed internally, the costs that can be accessed for each private market, and the implementation format, can change the estimated cost meaningfully – again using median costs from the CEM Benchmarking dataset. Exhibit 20 shows that implementing solely through a fund of fund structure could easily generate costs of £1.5 billion per annum (around 37 basis points of total Master Trust assets). Internalising LP selection and management could

reduce this annual cost to £1.1 billion (around 27 basis points of total Master Trust assets). Building a successful co-investment programme that took a full third of exposure through co-invests, leaving the remainder to be managed through a portfolio of LPs would cut costs down to £800 million per annum (around 19 basis points of total Master Trust assets), and leaning into cheaper Evergreen structures outside of private equity while maintaining a PE co-invest would reduce costs to £560 million per annum (around 13 basis points of total Master Trust assets).

These examples are all based on aggregate Master Trusts assets. Individually, it is not at all clear that any Master Trust would have the economies of scale to deliver a largely internalised route to market across all four private market spaces.<sup>66</sup>

## Notes

<sup>66</sup> Median costs incurred by 294 institutions in the CEM Global Universe for Direct LP investments in Real estate, Private Credit, Private Equity – Diversified, Infrastructure at 25% weight each are compared to median costs incurred by the same universe managing internal allocations to the same asset classes. The median asset base of the 294 institutions was \$29 billion. The median allocation to Direct LP across each of the four asset classes was \$665m, and the median allocation to internal across each of the four asset classes was \$3.8bn. Data is sourced from CEM Benchmarking, 2023. Investment Benchmarking Analysis (for the 10-year period ending December 31, 2022) Norwegian Government Pension Fund Global <https://www.regjeringen.no/contentassets/e48007a118414dae967b580c8105c661/cei-investment-benchmarking-analysis-2022-government-pension-fund-global.pdf>

## Exhibit 20:

10% of total Master Trust AuM, equally-split across 4 private markets

	Internal allocation	Internal cost	Cost £	Implementation	External allocation	External cost	Cost £	Total AuM	Blended cost as % alloc	Total £	External allocation	Lower bound	Higher bound	Cost as % of total assets
Real estate	£9.5bn	0.23%	£22m	Evergreen	£1.1bn	0.96%	£10m	£10.5bn	0.30%	£32m	10%			
Infrastructure	£9.5bn	0.26%	£24m	Evergreen	£1.1bn	1.57%	£17m	£10.5bn	0.39%	£41m	10%			
Private credit	£9.5bn	0.22%	£21m	Evergreen	£1.1bn	0.65%	£7m	£10.5bn	0.26%	£28m	10%			
Private equity – diversified	£5.3bn	0.41%	£21m	2/3 LP; 1/3 Co-inv	£5.3bn	2.15%	£113m	£10.5bn	1.28%	£134m	50%			
<b>Total blend</b>	<b>£33.6bn</b>	<b>0.26%</b>	<b>£88m</b>		<b>£12.6bn</b>		<b>£146m</b>	<b>£42.0bn</b>	<b>0.56%</b>	<b>£235m</b>	<b>20%</b>	<b>£201m</b>	<b>£268m</b>	<b>+0.06%</b>
Total cost 100% external w/ co-invest									1.33%	£561m		£481m	£641m	+0.13%
Total cost 100% external w/o co-invest									1.58%	£664m		£570m	£759m	+0.16%
Total cost 100% external via LP w/ co-invest									1.91%	£801m		£687m	£916m	+0.19%
Total cost 100% external via LP w/o co-invest									2.71%	£1,139m		£976m	£1,302m	+0.27%
Total cost 100% external via FoFs									3.68%	£1,545m		£1,325m	£1,766m	+0.37%
<b>Total cost 100% internal</b>									<b>0.28%</b>	<b>£117m</b>		<b>£100m</b>	<b>£134m</b>	<b>+0.3%</b>



# Models for taking private market exposure

The practicalities of building internal private market investment capabilities are non-trivial. Greater internal management comes with the prize of a more bespoke set of investment assets and lower implementation costs for very large funds. But it also comes with greater fixed costs, and requires investment to build an array of investment, operational, regulatory, and governance capabilities.

## A spectrum of models

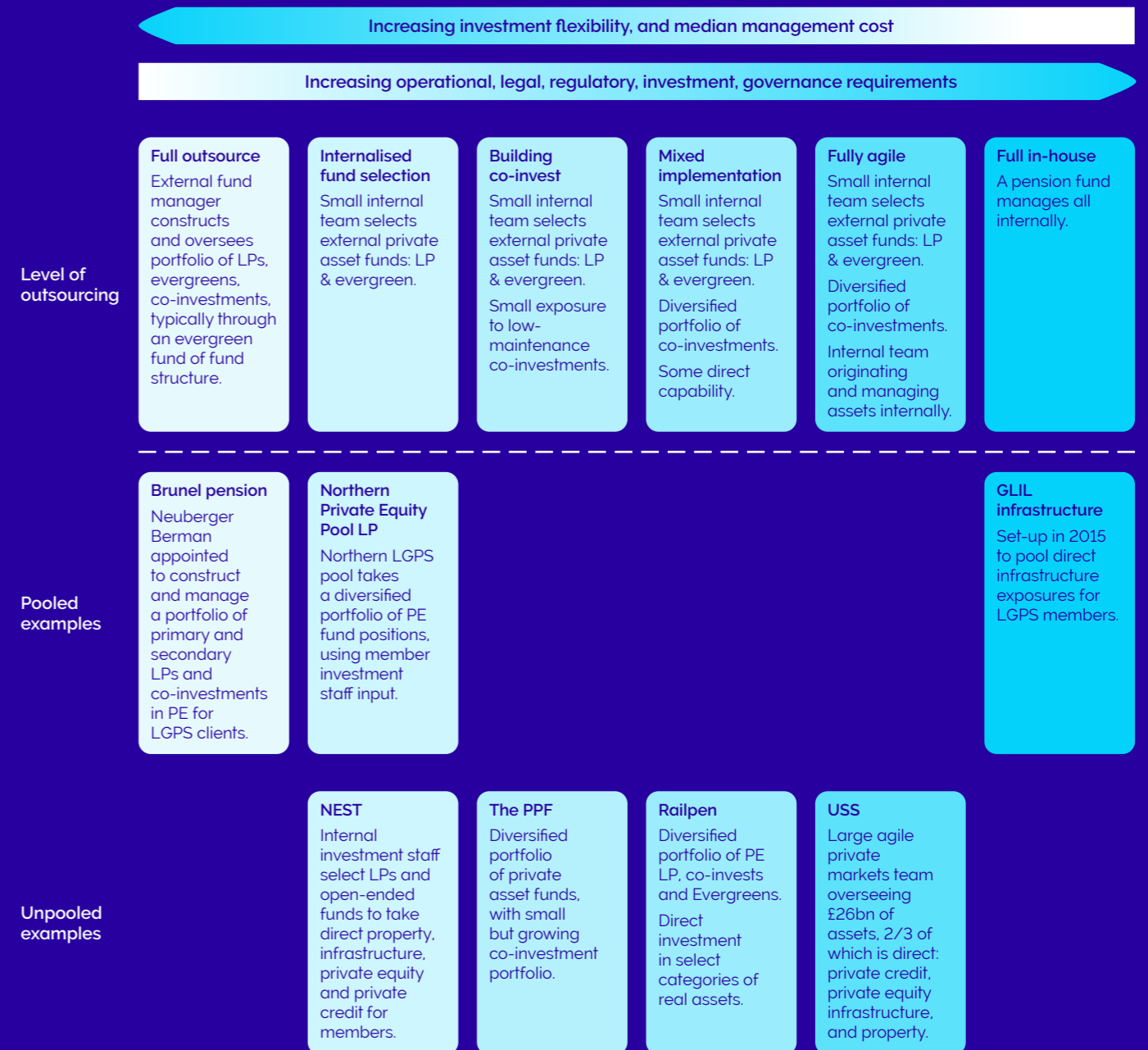
Fortunately, the decision as to whether to manage internally or externally is not all-or-nothing. There is a spectrum of possible models. And it is possible to start with one model, then add or subtract internal capabilities to switch right or left on the schematic. The optimal model for any institution will depend on:

a) the scale of the pension fund's asset base, b) the number of private market asset classes required, c) the average projected investment to these asset classes over a cycle, and; d) the nature of the fund's investment philosophy and process. There is no one-size-fits-all solution.

Exhibit 21 shows an array of private market allocation models at the top-line in schematic form. Management costs attached to models tend to decline as you move from left to right when implemented by large institutional investors. Below the dotted line are some examples of how these models have been implemented by UK pension funds. All of them are legitimate models with costs and benefits.



**Exhibit 21:**  
The spectrum of models used by UK pension schemes to gain private market access



Sources<sup>67</sup>



## Single-pension fund models

**Nest Pensions** – the UK’s largest defined contribution Master Trust managing £37 billion of assets<sup>68</sup> – takes direct exposure to a variety of open-ended evergreen private market funds on behalf of its members. Costs are not disclosed, but Nest has made public that they do not pay carry/performance fees on any of their investments. Private equity was added to their default growth and default foundation portfolios in 2022, with mandates awarded to HarbourVest and Schroders.<sup>69</sup> Both are open-ended funds taking co-investments in deals considered too large for their managers’ main funds. They take infrastructure exposure through a Limited Partnership in an open-ended fund

managed by GLIL Infrastructure – a pooled direct investor in infrastructure assets established by four Local Government Pension Scheme administering authorities – as well as partnerships with Octopus Energy and the commercial asset manager CBRE. Private credit exposure is taken through Amundi and BlackRock. JP Morgan’s timberland investment company – Campbell Global – has recently been appointed to manage timberland investments.<sup>70</sup> And direct property exposure is built using LGIM’s open-ended LPI Income Property Fund, which focuses on inflation-linked rental streams attached to properties let out on a long-term basis to low-risk tenants.

The **Pension Protection Fund** – the £33 billion<sup>71</sup> lifeboat for the UK private defined benefit system – has a series of matching assets for its liabilities. But its surplus is invested for growth. Included in this growth portfolio is sizeable exposure to private market assets. Of its £33 billion portfolio, 26% is held in Alternatives – including a range of private market assets. They have £2.6 billion invested in infrastructure and timberland, and a £2 billion exposure to private equity through a variety of LP positions and a meaningful and diversified co-investment programme. Around a quarter of the £1.75bn real estate portfolio is held directly, with some external managers bringing assets to the PPF for approval before including them in separate managed accounts. And a substantial proportion of the £2.5bn private credit is managed internally.<sup>72</sup>

Directs are not a dominant part of any of the PPF’s private market portfolios besides private investment grade credit, but the capability exists to invest directly across many elements. The PPF believes that they have the ability based on experience, knowledge, governance to implement their portfolio construction in the most optimal way.

**Railpen**, the £34 billion multi-employer pension scheme for around 350,000 current and former employees of firms connected to the rail industry, has increasingly moved management of investments in-house. It began moving some public market investment in-house in 2014 and since 2016 has built capability to manage direct property internally.<sup>73</sup> Internal teams originate direct UK infrastructure investments, while typically using third parties to originate and manage overseas exposures. The fund takes private equity principally through a portfolio of LPs, and uses partnerships with GPs to gain access to a wide array of co-investment. Overall Railpen has a team of twenty-five managing private market and real asset portfolios.

But perhaps most interestingly, **Universities Superannuation Schemes** – the largest single pool of pension assets in the UK with £79 billion under management – has grown a capability in private markets organically over the past seventeen years to arrive at a fully agile model.

**Exhibit 22:**  
PPF implementation method by private market asset class





BOX 3

## The evolution of USS Private Markets

Today USS is the largest private market asset owner in the UK, with around a third of its £79 billion total scheme asset invested in private assets. This is a world away from the £1.5 billion invested largely through external private asset managers in 2007.

The scheme was initially committed to investing in external funds, and began to co-invest with GP partners almost immediately – reducing the cost of implementation for members while gaining valuable skills and internal capabilities. The initial focus was on operationally undemanding investments that would deliver long duration stable cashflows.

Having accrued four years of experience of private market management, and built a private markets team of 14, USS executed their first direct infrastructure transaction in 2011. By 2015 when USS conducted their first direct private equity deal, the private market asset base had increased to £11.3bn and the team had grown to 35. By 2020 they had further expanded the team to number 48 and had launched a matching asset programme that included long income property. Today the private assets team has 72 members managing £26 billion of private market assets. See exhibit 23.

Despite significant internal origination and management capacity across infrastructure, private credit, and property, a third of private market assets continue to be invested through external private market asset managers. Externally managed funds provide USS with access to investments that sit outside the internal teams' core management competencies by geography or sector. But importantly, external funds provide USS's internal staff access to top external fund teams across private markets, providing exposure to origination channels and deals. Furthermore, they provide a strong pipeline of co-investment opportunities.

Co-investment in private equity has become a well-trodden path across the industry, but is less common in private credit, infrastructure and property. Having strong internal capabilities has allowed USS to leverage their GP relationships to develop co-invests in these areas too. The private markets team reviews around four or five co-investments a month and can pick and choose where it participates.

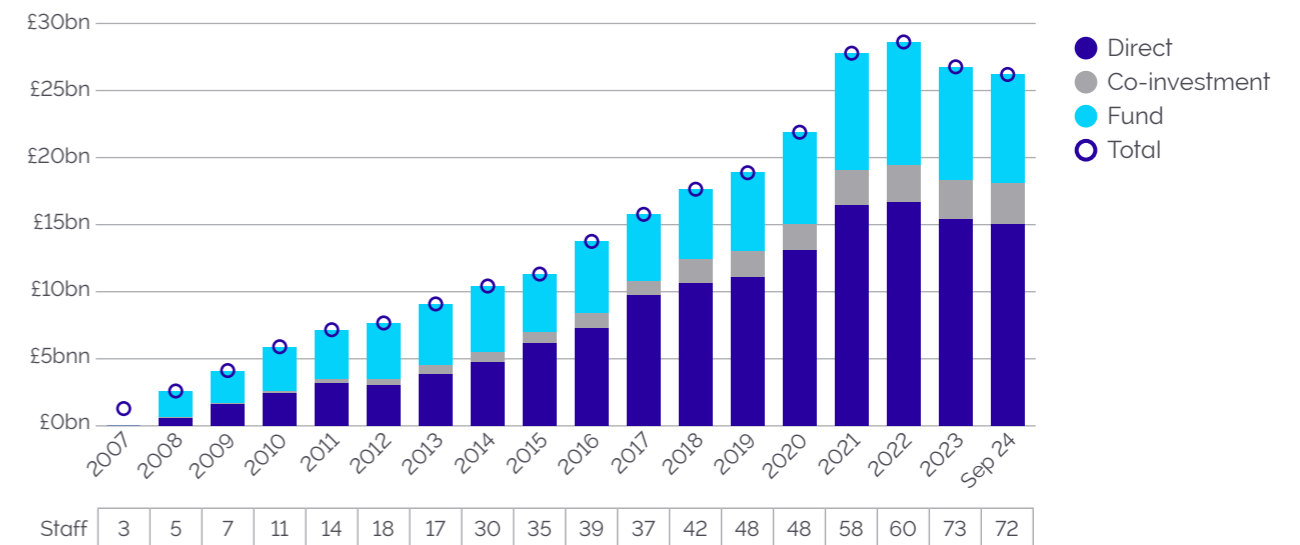
In managing most investments directly USS can invest for the long-term rather than fall in with the cadence of ten-year private fund disposal time-frames common to closed-ended funds. As well as being potentially better for portfolio firms, such semi-permanent investments can also be a better match to USS's pension fund liabilities. Internal management has allowed the acquisition of some assets on a buy-and-hold forever basis if they fit the scheme's needs.

Organisationally, USS has built four distinct private market investment teams: Credit, Property, Infrastructure and PE Funds and Co-investment. These teams manage assets split across five asset allocation buckets and belong to seven mandates. The asset allocation buckets are designed to be considered by overall USS scheme asset allocators alongside their public market cousins. This structure has evolved significantly over time before arriving at this point, adapting as resources and capital have been added to the group. See exhibit 24.

As an open defined benefit scheme (with a small defined contribution scheme for AVCs and excess salaries above their DB salary threshold), liabilities are long-term and growth is still important. As such, the bulk of private market assets are in the Real Growth and Private Growth buckets where risks are higher and return expectations more challenging.

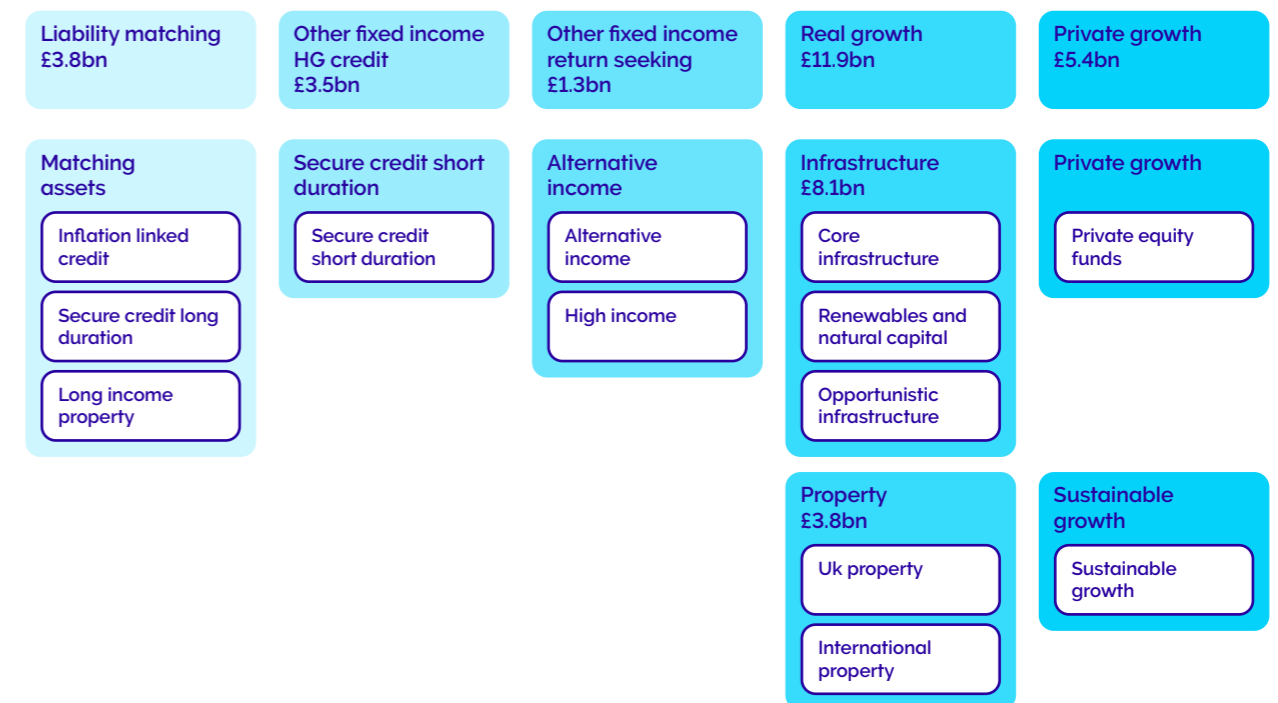
### Exhibit 23:

USS Private Market Group staffing and assets by implementation, 2007-2024



### Exhibit 24:

USS Private Market Group mandate and strategy structure, September 2024



## Pooled pension models

In section 3 we looked at the evolution of IFM Investors and ISPT in Australia – private market direct managers of infrastructure and commercial real estate respectively. These institutions were established by Australian non-profit Industry Funds with the help of labour unions, which were integral in the foundations of the modern Australian pensions system. There are some analogous collaborations across public and private sector pension funds in the UK over the past two decades.

### UK Public sector pension pooling of private market assets

The largest funded pension scheme in the UK is the Local Government Pension Scheme (LGPS) of England and Wales, with £354 billion of assets as of March 2023. Administering authorities collectively allocate £83 billion of these assets to private markets.<sup>74</sup> But the fragmentation of the LGPS into 88 distinct administering authorities, each with separate governance structures, investment committees and different strategic asset allocations means that the benefits of scale are immediately lost.

Recent years have been marked by efforts to recover economies of scale by obliging administrative authorities to join one of eight new pooling organisations. And this has been accompanied by some success among select administering authorities to foster greater collaboration in the realm of private markets.<sup>75</sup> Furthermore, much of the Interim Report of the Pension Investment Review, published in November 2024, consisted of policy work concerned with building out LGPS economies of scale.

Several pooling organisations operate private market funds, and some use external private market fund of fund structures. For example, **Brunel Pension Partnership** appointed Neuberger Berman to manage their private equity allocation on as fund of funds, taking investment into LPs, co-investments, secondaries across buyout, growth, venture and turnaround sectors.<sup>76</sup>

Moving across the schematic in Exhibit 21, the Northern LGPS pool established the **Northern Private Equity Pool LP Holdings (NPEP)** as a vehicle that draws on the combined expertise of the internal teams of their members: Greater Manchester (£30bn), Merseyside (£10bn) and West Yorkshire (£20bn) pension funds. While each pension fund is

substantial and has internal resources needed to build a portfolio of private equity LPs, they collectively represent a more attractive partner to private equity GPs and seek to exploit this advantage to secure better terms for their members.<sup>77</sup> NPEP's ambition is to grow co-investments up to 20% of NAV, and now sits at 15%. To handle the due diligence requirements posed by the co-investment opportunities arising from their LP investments and relationships with GPs, they currently use HarbourVest for half of their co-investment commitments.<sup>78</sup> Deals flowing from NPEP's relationships with GPs make up the remainder of the co-investment portfolio.

Most ambitiously, a number of LGPS funds have come together to form **GLIL Infrastructure**. GLIL Infrastructure originates and manages direct infrastructure holdings for its (mostly) LGPS clients, bringing projects to an investment committee consisting of these clients and operates on a cost-recovery basis. This model looks very close to that deployed in the early life of super fund-owned Australian real estate manager ISPT. Just as ISPT did, GLIL is developing beyond these origins towards a model of low fixed management fees and non-executive representations on the investment committee to handle growth beyond its founding members.

The motivation for setting up GLIL in 2015 – like IFM in the Australian market – was to both save costs and build a portfolio of assets that better matched the requirements of Greater Manchester Pension Fund (GMPF) and the London Pensions Fund Authority (LPFA) – the original LGPS funds who bestowed upon it a commitment of £500 million. Infrastructure was chosen as an asset class because its long-term cashflows attuned to UK-inflation are aligned with the liabilities of the open defined benefit pension schemes. By 2018 three LGPS funds had joined and GLIL moved to an open-ended fund structure allowing the admission of further new members. Nest Pension joined as GLIL's first LP in 2021<sup>79</sup> and is subject to the same fees as founding members – until now recouped on a cost-recovery basis each quarter.

GLIL Infrastructure now oversees a commitment of £4.1 billion to direct infrastructure assets. What started as an origination challenge has increasingly become an asset management challenge, with fifteen assets that require oversight and management. Like any private markets operation, it is staff-intensive, with twenty-five staff involved in the investment and asset management of the fund, supplemented by a roster of external NEDs with specific industry expertise

that are employed to sit on the boards of portfolio companies. Underwriting, legal, IT, finance, and administration are all provided by Local Pension Partnership Investments (LPPI) – the LGPS pooling company set up by Berkshire CC, Lancashire CC and the London Pension Fund Authority. These services are provided as part of the terms of appointment by which LPPI – as an FCA-regulated entity – has been appointed as the Alternative Investment Fund Manager (AIFM) by GLIL (itself an AIF).

If pooling resources for private markets was an obvious way forward, it begs the question as to why it has not been done earlier. In fact, a high-profile attempt was made in the form of the Pension Infrastructure Platform.

### UK public-private sector pooling of private market assets: Pension Infrastructure Platform (PiP)

PiP was launched in 2011 as a not-for-profit sector-aligned investment management business – in a bid to replicate in the UK the success achieved domestically by Australia's IFM Infrastructure. The stated ambition from government was to match the UK's economic needs for infrastructure investment with pensions' financial investment needs, and generate £20 billion in new infrastructure allocation, £2 billion of which would be deployed in the first year of its life.<sup>80</sup> This ambition was not delivered. Nine years after launch it was acquired by Foresight Group with only £1.8 billion under management.<sup>81</sup> Its history holds lessons.

PiP lacked strong support neither from government nor from leading figures and institutions in the UK pensions world.<sup>82</sup> The Pension Protection Fund (PPF) and the National Association of Pension Funds (NAPF, now known as the PLSA) formed the investment management business in 2012 after signing a memorandum of understanding with HM Treasury that would allow them to discuss how they might be involved in any of 1,200 capital projects.<sup>83</sup> Ten of Britain's largest pension funds agreed to be Founding Investors and provided start-up capital.<sup>84</sup> Six schemes came from the private sector (BAE Systems, British Airways, the BBC, BT Group, Lloyds TSB, and Railpen) and four schemes from the public sector (the PPF, London Pension Funds Authority, Strathclyde Pension Fund, and West Midlands Pension Fund).<sup>85</sup>

In a submission to the CMA in 2017, PiP describes the operating principles agreed by founding investors, which aimed to deliver better value and

alignment of interest than generally achievable in the established third-party infrastructure investment management market.<sup>86</sup>

- Buy and hold investment strategy to minimise transaction costs.
- Sole focus on UK infrastructure assets generating long term, low risk, inflation linked cash flows.
- PiP as manager should only cover its costs, and not make a profit.
- Transparent, simple low fee structure with no additional profit sharing or management carry.
- All investors benefit from same terms and conditions regardless of size.
- Economies of scale are returned to all investors through progressively lower fees.

Beyond these principles there was little alignment. It became quickly apparent in the early days of PiP that the founding investors had different infrastructure objectives, and that PiP would only form a minority element of their individual total infrastructure allocations. Effectively, the founding investors put the start-up PiP business into competition with more established, commercial infrastructure investment managers.

Far from being homogenous, different forms of infrastructure carry a wide range of risk-profiles (see Exhibit Q). Mature pension funds seeking assets to match their long-duration inflation-linked liabilities will gravitate towards Core Infrastructure, which tends to see high single to low-double-digit returns. Meanwhile, schemes that are in inflow and are seeking capital growth may have an appetite for Opportunistic Infrastructure, with attendant development risks. Such investments can be cashflow negative for several years and tend to target returns of 15-20% per annum or more. With ten founding investors, there were ten voices in the room – often pulling in different directions.



Natural turnover among those senior executives most invested in the success of PiP saw commitment to the manager wane before it achieved critical mass. And the type of infrastructure demanded by founding investors also differed.

Some founding investors had a clear focus on Core infrastructure, seeking inflation-linked long duration cashflows, and happy to pool with others seeking the same if doing so would provide access to larger projects than they had capacity to invest in directly, or reduced idiosyncratic risk by establishing stakes in a larger number of projects than they alone had capacity to take. And if this was through a larger and more professionalised specialist team. Moreover, they were happy aligning to this outcome if it came with lower costs given the greater economies of scale.

Others saw PiP as the perfect vehicle for Value Added or Opportunistic infrastructure investments, replete

with development risk and potentially far higher returns. The kinds of risks attached to Opportunistic required specialist skills, negotiating planning hurdles and construction challenges – of which there are many, and where risks of substantial loss are significant.<sup>87</sup> Large pension funds with internal direct core or core plus infrastructure management capability might find value in outsourcing such higher risk infrastructure management to a third party – especially one determined to minimise costs and with direct access to government.

Between the extremes of Core and Opportunistic, there were plenty of visions as to what PiP should be. Such contrasting visions of what PiP might be were not at all compatible.

Staffing a brand-new infrastructure investment business from scratch meant building a team of people. While Founding Investors provided working

capital to the new organisation, the costs of bidding whole teams away from leading infrastructure investment houses, with the associated bonuses and carried interest, looked initially prohibitive. Furthermore, PiP was not, in 2014, FCA-regulated. It would take time to deploy money directly. And so PiP initially contracted investment management out to an existing external infrastructure manager, awarding its first mandate to Dalmore Capital in 2014.<sup>89</sup> It was only with the appointment of Mike Weston as CEO towards the end of 2014 that an internal team was built to originate projects. But by then three founding members had left, their initial commitment to PiP having depleted, and their infrastructure priorities and allocations having moved on.<sup>90</sup>

Even the structure of the PiP's investment vehicles drew out differences between founders. All founders agreed that PiP should adopt a standard LP/GP structure to begin with. They also agreed that open ended structures would be an ultimate ambition, but that they came with much more complex operational requirements so PiP would start with simpler, closed ended structures - but pushing out the investment horizon to twenty-five-year funds. This was agreed as a pragmatic approach to get things started. But some were committed to having Separately Managed Accounts – sharing in the economies of scale that PiP might grow from centralising infrastructure expertise, but taking on only those infrastructure investments that particularly suited the individual pension scheme, and minimising prospective conflicts of interest around liquidity provision. Separately Managed Accounts, however, worked against the hope from some schemes that they might be able to access a large pool of diversified infrastructure assets in the form of fractional ownership accorded with a single large asset pool.

Still, for all the points of difference it looks likely that PiP would still have attracted capital commitments from each of the founding investors as a lower cost route to market but for one point. The ten founding investors, by virtue of their size, typically already had some existing internal private market capability. Individually they lacked the scale to originate large infrastructure assets, or to employ vast teams of highly paid private market professionals required to originate a significant flow of projects. But almost all had expertise and experience in negotiating with GPs, and originating small direct assets. As such, their allocations to PiP would compete with internal allocations.

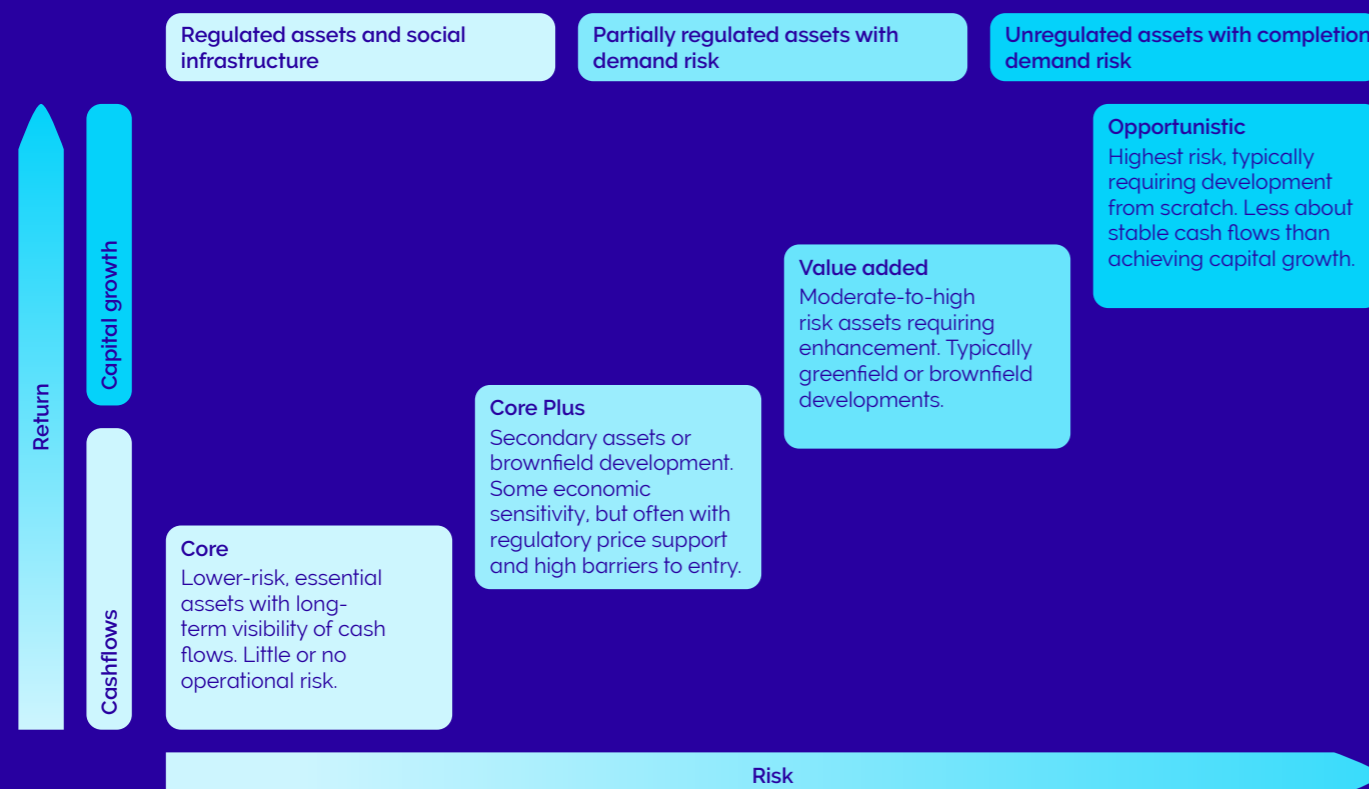
When PiP began direct asset origination it did so with easy to understand low-risk assets which were operationally undemanding. This made sense as a small start-up manager building its expertise. But such projects held little attraction for many of its investors. Committing capital meant, to some founding investors, allocating away from their internal teams to engage in similar projects on what looked to some like worse terms – in terms of costs, due diligence expertise, team experience, and scheme suitability. Some made token allocations. Others simply did not participate.

Government expectations were also a problem. HMT wanted pension schemes to invest in greenfield, new build, high risk infrastructure. Most pension funds wanted to invest in operational, brownfield, low risk infrastructure.

It's worth stating that there is little evidence that any of the founding investors were behaving unreasonably. And also worth stating that PiP, when faced with incompatible priorities, made a variety of decisions and business pivots that individually look perfectly rational. With the benefit of hindsight, one way forward could have been to have set up two separate funds: one operational fund and one development fund. But frustrating this potential solution was the central problem that PiP lacked a crystal-clear objective, absolute alignment amongst its investors, or alignment with government. It would've been easier to have two pension scheme investors than ten.

The biggest reason why GLIL Infrastructure has succeeded where PiP struggled is one of pension fund commitment. The commitment to PiP from its founder members was to set it up, but not to invest with it. Founding a direct infrastructure firm, but then putting it immediately into competition with internal infrastructure teams and established external managers before it had built a track record, meant that the manager lacked the economic scale to retain staff in the absence of business growth that it was unable to secure. GLIL by contrast has a smaller number of investors who are committed to use it as the conduit by which it will take infrastructure exposure.

**Exhibit 25:**  
Risk-reward profiles of infrastructure strategies



Sources<sup>88</sup>

## Design choices

When establishing a new sector-aligned direct private market investment vehicle there are a variety of design choices that need to be made. Exhibit 26 highlights some of the principal issues that executives at current and former firms have indicated are critical for founders to consider and agree upon with unanimity before progressing down the pooling route.

### Exhibit 26: Design considerations when forming a sector-aligned private manager

Issue	Question	Examples
Board structure and governance framework	Independent, or owner-led board/investment committee? <b>Issue:</b> <ul style="list-style-type: none"> <li>Independent board could drift away from core requirements of original owners.</li> <li>Owner-led board has the potential for setting up owner-vs-owner conflicts of interest.</li> </ul>	<ul style="list-style-type: none"> <li>IFM: Independent Board &amp; Investment Cmte</li> <li>ISPT/GLIL: Founder investor-led, with non-execs</li> </ul>
Type of investment	Direct-only or use of funds and co-Investments? Type of direct? <b>Issue:</b> <ul style="list-style-type: none"> <li>Seek alignment of objective and clarify what success looks like.</li> <li>Eg. Direct Core Infrastructure/Core Plus vs Direct Value Add vs Direct Opportunistic vs portfolio of LPs, Evergreens, SMAs, co-invests</li> </ul>	<ul style="list-style-type: none"> <li>IFM/GLIL: direct-only</li> <li>PiP: initially external, then later direct</li> <li>NPEP: external funds, with an ambition to grow co-invest.</li> </ul>
Geography of investment	Exclusively domestic vs international	<ul style="list-style-type: none"> <li>GLIL: overwhelmingly domestic, but with up to 25% international</li> <li>IFM: first domestic, then intl</li> </ul>
Investment vehicle type	Eg. single-pool open-ended fund vs successive closed-ended funds vs Separate Managed Accounts	<ul style="list-style-type: none"> <li>IFM: open-ended</li> <li>GLIL: open-ended</li> <li>PiP: 25yr GP/LP, with the ambition to shift to open-ended. SMAs.</li> </ul>
Time-horizon of investment	Is there appetite for permanent capital, and if so how should ownership be structured? What gating/liquidity restrictions should be established for any pooled open-or-closed-ended fund?	
Resourcing	Shape of staffing model and source of funds/staff?	<ul style="list-style-type: none"> <li>PiP: 10 founder partners committed capital to start-up the firm, but not to invest with it.</li> <li>IFM: Founder owners commit equity capital to new venture</li> <li>GLIL: cost recovery through a pre-determined split</li> <li>NPEP/ GLIL: secondment of specialist staff</li> </ul>
Cost structure	Management fee vs cost recovery	<ul style="list-style-type: none"> <li>IFM Investors, IPST &amp; GLIL later years</li> <li>IPST &amp; GLIL early years</li> </ul>
Openness to new third-party money	Is third-party money needed to grow? Would new business be on a profit-making basis?	<ul style="list-style-type: none"> <li>IFM: Profit-making, with profits reinvested in the business or distributed to shareholders.</li> </ul>

## Notes

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# Conclusion: the way forward

Using external private market asset managers is expensive. Complex multi-layered fee structures can detract from investment returns. And numerous studies point to this fee drag being large enough to offset any performance advantage that private markets bestow.

Managing private markets internally is cost effective, but only at scale. High fixed costs attached to setting up and maintaining a world-class internal investment capability can be easily absorbed by very large pension funds, providing them superior net returns. But the scale of commitment required to deliver economies of scale in multiple private market asset classes puts this approach beyond reach to most.

There is a middle ground. USS has provided a model for how pension funds could build exposure to private markets organically – starting with a model akin to that used by NPEP, and developing it through time to that used by the PPF. As scale and expertise are achieved so internal private market areas can be added. Only with sufficient scale can a fully agile end-point be realised. Internalising capabilities is far from an all-or-nothing enterprise, and its benefits are dependent on scale.

Examples across the LGPS pools have shown how UK pension funds can collaborate to achieve scale across any number of different pooling structures, from low-touch fund of private asset funds all the

way to the high-touch origination and management of private assets as executed by GLIL Infrastructure.

But the experience of Pension Infrastructure Platform has shown how hard it can be for multiple pension funds to come together and achieve the goal of cost-efficient investment in private markets. An extremely high level of alignment of interest and vision on the part of participating funds is required that cannot be manufactured or imposed, no matter the political weight or goodwill bestowed. See exhibit 27.

Given that benefits accrue with scale and the staff-intensive nature of private market investing, it would make sense for pension funds to partner in building capacity in the form of a sector-aligned private markets unit if this were feasible. In the absence of such alignment, fully-agile internal management should still be the goal, and there is a path to this end point that the largest Master Trusts can take.

This could be built initially with the capacity to select and manage externally managed private market funds exposure, and in doing so accrue the expertise necessary to source, conduct effective due diligence on, and construct a diversified portfolio of co-investments in portfolio companies/transactions in one or more private market areas.

Setting up a pooled private market manager is replete with operational risks, and a good place to start could be for an existing pension fund or pool with internal management capabilities and strong governance to step up into the role of a not-for-profit sector-aligned private market aggregator. USS, The Pension Protection Fund, or Local Pension Partnership Investments all stand out as good aggregator candidates. Whether they have the appetite or capacity to engage in such a role is another question.

If starting from scratch, there are dangers in trying to do too much too quickly. Origination and management of private assets is hard and requires significant resourcing and expertise. There's a reason why private equity managers can command high fees. But as peer data from CEM Benchmarking shows, open-ended/ evergreen structures in private credit, real estate, and core infrastructure offer quick routes to invest assets at less egregious costs.

The challenge is significant. But the prize – close to a billion pounds a year in member savings by 2030, and better pension outcomes for millions of members – is worth the effort.

**Exhibit 27:**  
Mapping a path towards the creation of a fully-agile internal manager





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