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Introducing Sustainable Investments Solutions to DC – UK Insight

Alex Snowball, Strategic Relationship Director to DC, LGIM

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CAPITAL AT RISK



UK DC Market

Change has been significant in the last 15 years

Automatic enrolment - helping individuals to accumulate pension savings.

Introduction of legal duty for employers to enrol certain staff into a workplace pension scheme and contribute towards it.

- Default investment option.
 - Typically 'Lifestyle funds' listed equity, fixed interest and cash.
- Charge cap of 0.75%
 - Applies to all scheme and investment administration charges.

Key features of UK DC

- Corporate and trustee decision of DC provider and investment default.
- Individual self select investment choices.
- Daily subscriptions and redemptions.
- Daily pricing.
- Individual and scheme level portability.
 - Individual and bulk transfers.
- Pension freedoms - end of near-compulsory annuitisation.
- Access to retirement saving (Age 55 onwards).

Since the introduction of Automatic Enrolment and with this default investment options, there has been increasing drive from regulators, trustees, corporates to ensure investments are sustainable and deliver members' value for money.

One way to achieve higher returns, net of cost, is to invest in longer-term, less liquid assets, managed appropriately.

Investment in such assets, including productive finance assets, could also benefit the wider economy. It can support the supply of long-term capital, financial stability and the transition to net zero. Examples of productive assets include research and development, technology, and infrastructure.

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The opportunity and parameters of DC

Opportunities

- Introduction of longer-term, less liquid assets such as productive assets including research and development, technology, and infrastructure to enhance member investment outcomes.
- Increased diversification benefits versus public markets, with alternate sources of risk/return thereby complementing a more traditional portfolio of equities and bonds.
- Unlocking of up to £50 billion within UK Defined Contribution pension schemes.
- Further support the transition to net zero.
- Compliance of Value of Money framework.

Parameters and Challenges

- Liquidity for redemptions and subscriptions.
 - Private markets are generally illiquid and inherently have a longer-term holding period.
- Daily pricing to support DC activity.
 - Private market and illiquid assets valuations are not as frequent as traditional listed assets used in DC.
- DC charge cap.
 - Private markets and illiquid assets fees are significantly higher than traditional listed assets used in DC.
- Legal structuring and investment monitoring.

Committees and working groups across the industry have been debating changes to regulation and creating solutions to make private market and illiquid investment possible in DC.

There's been good progress with the introduction of new regulation and structures, however there is still further work needed to introduce solutions that can benefit members across UK DC in an important way.

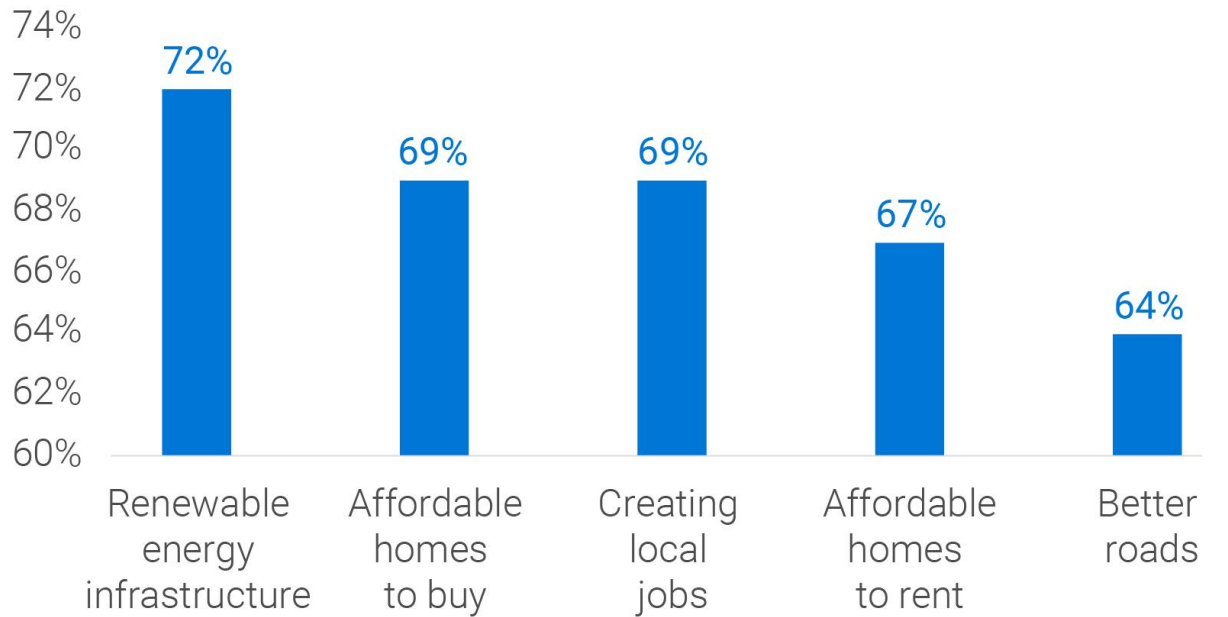
It's clear from research is that UK DC members would like to see private market and illiquid investment in DC, even if it means paying more.



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Member research and views

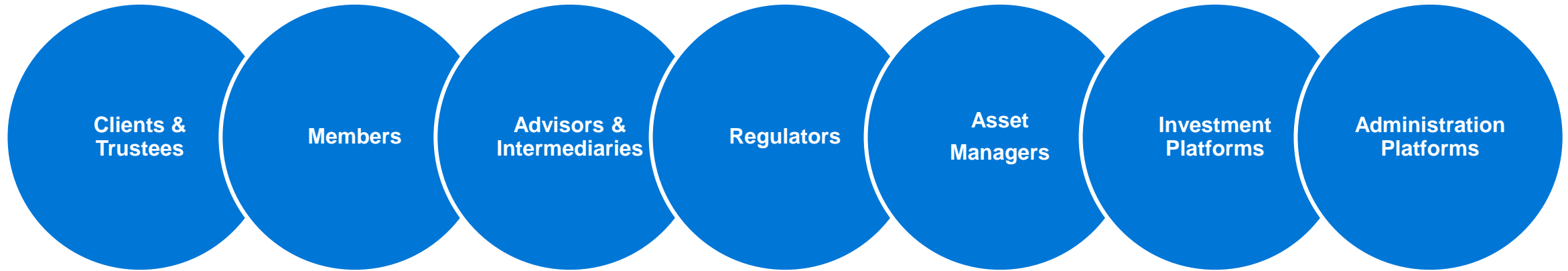
I would pay higher fees in my pension for funds that invested in:



Source: Legal & General Investment Management (LGIM) survey in June 2023 of the views of 3,634 defined contribution workplace pension members in the accumulation phase, on environment, social and governance investing. Respondents were split across generations and genders and across the UK.

Designing and Creating a Solution for DC

Understanding of stakeholder requirements are of the utmost importance



- **The Market:** There is a clear need for ‘packaged’ illiquid solutions as opposed to individual asset classes.
- **Full solutions:** Current solutions entering the market are not fit for purpose in isolation – several asset managers have launched / about to launch Long Term Asset Funds (LTAF).
- **Fees:** Must offer good value relative to return target. Performance fee smoothing is required.
- **Portfolio:** Focus on sustainability / ESG and maximising illiquid assets within DC parameters.
- **Regional diversification:** Preference for a global portfolio with UK focus in order to access a wider range of opportunities.
- **Fund structure/liquidity:** The structure of solutions for DC is key; LTAFs alone have operating and governance challenges. Liquidity profile is vital.

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Key Risks

The value of investments and the income from them can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance.

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