ROYAL LONDON

Works for you

Understanding private markets

Contents

There's been increasing focus on the use of private market assets in investment portfolios on the back of regulatory and political activity, as well as innovations in markets and availability. Here we look at what private market assets are, their relevance and how we use them in our investment solutions.

What are private markets?

Private market investments are assets that aren't traded on public markets. In other words, assets which don't have the same disclosed information as publicly listed assets, such as daily pricing. They include:

- private equity
- infrastructure
- property, and
- private debt.

Why use private market assets?

Potential to improve customer outcomes

Within diversified multi asset portfolios, private market assets can help enhance expected returns and/or reduce volatility. This is because they're generally affected by different economic drivers than publicly traded assets such as equities and bonds.

Industry and regulatory focus

There's a growing regulatory and government focus on making it easier for defined contribution (DC) pensions to invest in these types of assets. For example:

- The introduction of 'Main Scale Defaults' within workplace pensions through the Pension Schemes Act, with £25bn minimum assets under management by 2030.
- Encouragement for DC pensions to invest in productive assets/finance – especially in the UK – also through the Pension Schemes Act.
- The introduction of long-term asset funds (LTAFs) and changes to the types of assets which are allowed in insured unit-linked products (known as COBS-permitted links).

Why haven't private market assets been widely used before now?

Cost

Private market assets are typically more expensive than traditional public market options. So, it's been difficult to incorporate them when costs are already so tightly managed – especially in the workplace DC market.

Liquidity

Private market assets are less liquid, presenting operational challenges. This includes not being able to provide a daily price, which is a requirement for most funds used in the UK pensions market. If there's significant volatility (in either public or private markets), you can't quickly buy or sell these illiquid assets, which, in turn, can put pressure on the overall portfolio.

Perception

High-profile fund suspensions (property and Woodford funds being a couple of examples) have contributed to a negative perception around illiquid assets.

Regulation

Previous Financial Conduct Authority (FCA) rules made it difficult for providers to include illiquid assets in pensions. However, recent changes have opened up opportunities – for example COBS-permitted link changes in 2020 and approval for LTAFs being used in 2021.

Expertise

Investing in private markets needs specialist knowledge and experience. The right expertise has often come at a premium, linking to the cost aspect.

Risk/Return pay-off

There's less publicly available information for private market assets than traditional publicly traded investments, making it more difficult to form robust views or set informed expectations on future return potential. While some models assume superior returns for certain private market assets, there's debate and scepticism on being able to translate some of these strong modelled or simulated returns into actual returns.

In addition, although nobody can predict the future for any asset class (public or private), the dispersion in realised returns compared to "predicted" returns can be greater in private markets than in their public market equivalents. For example, just because private equity has an expected return of x% doesn't mean you'll get x%.

Our current position on private markets

Illiquid investments aren't new to Royal London. We already include physical property and asset-backed securities (ABS) in our flagship Governed Range, including our default investment options. But with the evolution of private markets and increasing demand for investment in alternative asset classes, we plan to expand the Governed Range's investment in private market assets.

We've strengthened our in-house private market expertise, notably through the expansion of the management team within Royal London Asset Management and the acquisition of Dalmore Capital, an infrastructure specialist.

One of the benefits of being the largest mutual life, pensions and investment company in the UK* is that even when we've expanded our investment universe and incorporated assets such as property and ABS, there hasn't been any increase in costs for customers. And our size and approach have led to active engagement with government and industry bodies, giving us a voice in shaping policy in this area.

What next?

Our aim is to provide financial security and resilience for our customers, and we believe including private market assets can help achieve this goal. But it's important to remember that investment in private markets doesn't happen overnight.

We'll continue to be disciplined in making sure we find the right quality investments, reinforcing why we don't just follow what competitors are doing or make knee-jerk allocations.

The acquisition of Dalmore is an example of us continuing to build capabilities that can benefit our customers. But our strategy is about thoughtful, customer-focused investment solutions. We don't believe it's in customers' best interests to expect them (or employers in the case of workplace schemes) to make investment decisions to access our best thinking.

In the workplace space, we also aren't playing into the debate of core/premium defaults – we're using our position as a mutual to incorporate best thinking as standard within our default option.

*Based on total 2022 premium income. ICMIF Global 500, 2024.

Glossary

Private markets: this covers the investment universe of assets that aren't traded on public markets. It includes everything from private equity and private infrastructure, all the way through to direct lending and physical property. While these assets don't trade through traditional exchanges or have a readily available publicly disclosed price, the universe for private markets is large and diverse. According to Russell Investments, there are 95,000 private companies generating over $100m in annual revenue. In contrast, there are only 10,000 public companies of the same size.

Infrastructure equity: infrastructure is a broad term covering systems and services needed for the economy and society to function. These include things like renewable energy, utilities and regulated networks, transport assets and digital infrastructure. Infrastructure equity is when you invest in projects which build or create these systems and services.

Illiquids: these are investments that don't have the same liquidity characteristics (ability to trade) compared to traditional listed investments, such as listed equities and bonds that can be bought and sold daily. Illiquids include things like property and forestry, which are less liquid and can't be traded/transacted as easily as there's no public exchange to enable this.

Alternatives: this refers to investments which fall outside traditional asset classes such as equities, bonds and cash. It includes a range of private market assets, as well as things like commodities and collectibles.

(UK) productive finance: this definition is more subjective, but broadly speaking it's looking at purposeful investments that can help accelerate the growth of the UK economy and society.

Mansion House: this was a voluntary industry-led initiative aimed at increasing investments in unlisted investments, with a particular focus on the UK. It's mainly DC focussed, targeting 5% investment in unlisted UK assets by 2030.

Long-term asset fund (LTAF): this is a type of FCA-authorised fund designed to make it easier to invest in long-term, illiquid assets such as private equity, venture capital, real estate and infrastructure. Introduced in November 2021, LTAFs are specifically structured to allow access to these investments for a broader range of investors, including retail investors.

For more information about private markets and Royal London's investment solutions, speak to your usual Royal London contact.

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