cio investment club

Whitepaper #5

August 2024

Alternative Investments: Private eyes on the UK pension and insurance market

In association with

CLEARWATER ANALYTICS

BRIGHTWOOD

Roundtable sponsors

Thank you to our sponsors for this edition of the Alternative Investments Whitepaper.

CLEARWATER ANALYTICS

BRIGHTWOOD

Contents

sean.thompson@cioinvestmentclub.com

www.cioinvestmentclub.com

cio-investment-club

Design by Go Vicinity Creative

CLEARWATER
ANALYTICS®

55%

of firms expect to increase investment into alternative assets over the next 5 years.

72%

of firms find a pressing need for multiple advancements in operational efficiencies and software capabilities.

28%

of firms find standardisation of data to be the biggest area of improvement for alternative investments.

Navigate the future of alternatives with confidence.
Navigate the future of alternatives with Clearwater.

Data Standardisation | Data Connectivity
Regulatory Reporting

Learn More

All stats taken from a flash poll survey report ran by Clearwater in 2024, read that study **here.**

Private eyes on the UK pension and insurance market

Private Markets, especially Private Debt, can hardly be considered as alternative, given many institutional investors have more than 20% of total assets allocated there. Some consultants advocate exposure of 50% while the 'Canadian model' – wherein well-resourced internal teams readily take major stakes in privately held businesses - is admired worldwide. By and large, greater allocations have been rewarded. LPs grumble about terms and fees but have not been disappointed or exited these strategies. COVID was a good test which GPs of debt and equity vehicles passed with flying colours.

The future, however, is not so certain. Rising rates have opened up two possible causeways to withdrawals. The first is obviously lower valuations. If nothing else, the prospect necessitates a re-evaluation of expected returns. There is still plenty of dry powder in Private Markets but perhaps it has to remain on the sidelines until sellers accept the reality of lower prices. That is not helped by the fact that more and more companies taken private remain private, so there is not the froth and buzz around an IPO to give prices a boost.

GPs have, however, been inventive in creating continuation vehicles and more secondaries funds to give more options.

The second causeway is the desire for pension funds and other institutional investors to de-risk. Especially if they are headed for buy-out, pension funds will want readily transferable assets. The lure of higher returns, even from Private Debt, no longer interests them. For those further from buy out, there are still the after-shocks of the gilts crisis. Surprisingly, many pension funds are not strategically decided on how much Private Markets exposure they want under the new regime.

A trend going the other way, however, is the desire for individual savings, especially within DC pensions, to work harder. For these pots of capital, Private Markets have long been out of reach, mostly because investment vehicles for DC pensions typically have to have daily dealing. It is a condition that is gradually being worked around; one to be discussed at the cio investment club roundtable.

With private markets AUM on an upward trajectory, we invited asset owners and investment consultants to discuss some of the key challenges in the private markets space. Join us on the journey as we discuss data transparency, investment preferences, ESG and more.

Participants

Richard Moon, head of private markets, **Railpen**, the £33bn pension fund for UK railways

Ian McKnight, head of OCIO at **Cartwright**, a pension fund consultancy

Rohit Kapur, head of private markets investments in **Schroders**' OCIO team

Imran Bora, portfolio manager at **Brightwood Capital Partners**, a mid-market private debt manager

Stephan Breban, head of research at energy investment platform, **Renewity**

David Devlin, strategic partnerships director at **Phoenix**, the UK's largest long-term savings and retirement business

Peter Martin, Investment Officer of the **Medical Defence Union**, which has £1.2bn in assets under management

With operational commentary from:

Brian Slattery, Head of Insurance EMEA for investment management technology provider, **Clearwater Analytics**

Transparency is Key

The cio investment club roundtable on Alternative Investments began with the topic of access: how pension funds, insurers and family offices can get first sight of the best privately financed deals.

Connectivity and access to information is a game changer in this industry.

From strong relationships with General Partners (GPs) to quick access to data to inform investment decisions. But it's no secret that accessing data is only part of the problem.

Richard Moon, head of private markets at Railpen, said it had strong relationships with a small number of Private Equity General Partners (GPs) and was proactive in conducting due diligence on co-investment alongside them. "Having these deep relationships ensures that we see high quality co-investment deal flow from our GPs," he said. "Our experience of having worked with them on deals previously enables us to conduct our due diligence swiftly, which works well for both parties."

Ian McKnight, head of OCIO at Cartwright, reckoned that in the European private debt space, there were five or six top-tier players to know.

Rohit Kapur, head of Private Markets investments in Schroders' OCIO team, discussed how LPs actually release capital to GPs. He recommended considering a trigger account that automatically started investing as a certain spread level was reached. "However, you can't hold everything waiting for the big event," explained Kapur. "You want managers who can invest across the cycle."

Imran Bora, portfolio manager at Brightwood Capital Partners, asked whether, given their well-established relationships with managers, the asset owners were constantly underwriting new managers. If so, how do these new managers get on their radar?

Moon replied that when Railpen is writing tickets of US$100m or more in core Private Debt mandates, it generally structures through Separately Managed Accounts, which gives greater control over things like investment pacing and concentration limits.

"In lower-risk Private Debt strategies we tend to contract with just one GP per strategy, so we ensure we know the market participants operating around these core holdings. They are the best-in-class managers, investing through the cycle," said Moon.

Bora said he was curious how asset owners differentiate between different managers within the same strategy.

McKnight said access was getting harder in the UK market as local authority pension pools were taking bigger tickets. He felt that concentration was edging out niche opportunities and managers, although he said there was still a broad spectrum at the core.

Kapur described direct lending as a beta play to which the top handful of managers in Europe will give you exposure.

"The tipping point," warned McKnight, "is where they become asset gatherers and lose their soul."

"They are the best-in-class managers, investing through the cycle"

Slowly Going Green

Stephan Breban, Head of Research, Renewity, turned the conversation to the energy transition. He reckoned the global shortfall on investment was US$300bn per annum if 2050 targets are to be reached. "We are roughly halfway where we need to be," he said. "Infrastructure projects are typically 80% funded by debt. So, we need US$60bn in equity and US$240bn in debt. Who is going to invest that? Some institutions could be matching their liabilities with debt."

Brian Slattery, Head of Insurance EMEA at Clearwater Analytics, asked whether insurance companies in the UK buy-out market will buy pension assets if they are private debt or equity? Thus far, such transfers have not been welcome.

Breban responded that insurers still need shareholder capital and might prefer equity-oriented green infrastructure.

Kapur wondered whether the new Matching Adjustment under UK Solvency [the post-Brexit successor to the EU's Solvency II] would change insurers' appetite. Among the various modifications, there was potential scope for some different holdings.

David Devlin, strategic partnerships director at Phoenix, said that up to 50% of its Private Markets portfolio on the balance sheet can be in private debt. Each year typically upwards of 70% of sourced debt is sustainable.

In answer to Slattery's question, Devlin noted that when it comes to the Phoenix balance sheet, interest, inflation and currency risks are viewed as unrewarded and hedged within very tight bounds.

Peter Martin, CIO of the Medical Defence Union, said even if pension funds invest more in this area, a lot of Defined Benefit (DB) schemes will no doubt consider and enact plans for endgame solutions. "Annuity providers will potentially be very unwilling to receive these assets," he said.

On policy influencing long-term asset allocation, Devlin referenced the Mansion House reforms of 2023, when leading pension providers in the UK responded favourably to the government's call to invest more retirement savings into Britain-based start-up enterprises. "That was expect to see a step-change in unit-linked savers' exposure to private markets," he said.

Breban said the reforms were never going to happen. "Every other government has failed in this policy," he warned. "Labour is under pressure to fund a lot of things. Nothing is sacrosanct, including pension funds. There is a real danger of pushing them into infrastructure. That will push up the price of everything and when they get out the opposite will happen."

> *Pension outgoings on such a scale may be as unaffordable as Net-Zero*

Devlin agreed that we need to be wary of supply/demand dynamics. For example, when the EU reduced capital requirements for infrastructure debt versus corporate credit, relative spreads tightened to such an extent that infrastructure debt was significantly less attractive.

McKnight said that the new UK administration had the water companies to take public, then the railways: "It has bigger fish to fry than interfering with pension funds or spooking the markets with government intervention."

On funding green infrastructure, McKnight said LGPS schemes have already shown willingness to be local place-based investors of projects such as affordable housing.

DB corporate schemes, however, remain stifled by liquidity constraints two years after the gilts crisis, according to Kapur. "The handcuffs are still on," he said. "Yes, some funds have better funding ratios but their liquidity and asset profiles aren't necessarily where they want them."

Martin predicted that many smaller DB schemes will be 'encouraged' to consolidate into larger pools such as consolidators whereas asset owners such as the PPF and master trusts in DC will potentially prove evergreen investors in private markets. Regarding the investment universe of opportunities, he said: "I am open in principle to more private assets if appropriate for our needs, but responsibly aligned investment options would need also to be considered."

McKnight reckoned this trend would be overwhelmed by the greater threat to investments from the rising indebtedness of the public sector. "What is coming from the US is a transfer of wealth from asset owners to non-asset owners via inflation or taxes or increased debt. How else can the public sector, at state or federal level, meet its liabilities? Some of the Chicago pension funds, for example, could potentially run out of assets in the not-too-distant future.

"Pension outgoings on such a scale may be as unaffordable as Net-Zero," said McKnight. "The US is in a mess on the public funds side longer term. Nobody really talks about it as it is beyond the timescale of existing administrations, but the looming crisis is there for all to see."

On the bright side, nevertheless, he did see potential efficiencies. For example, Scotland could generate enough renewable energy to serve the entire UK. Here, Breban agreed it was a case of improving distribution. "What we need is connectivity," he said. "Germany is spending more on this right now than renewables."

Bora wanted to know how reassured asset owners felt when state entities guaranteed the loan. Martin replied that asset owners need to take account the potential impact of state intervention, giving the example of bonds for EDF, France's state-owned electricity provider, falling 15-20% after the French government capped energy price increases.

Bora then asked about the euphoria for private markets from an allocator's point of view. More specifically, he asked whether assets will reallocate to private equity from private credit if base rates decline from here. "It is unclear if allocations change should rates go down," he suggested.

McKnight said that 'if' was doing a lot of heavy lifting in that statement.

Devlin said that at Phoenix all balance-sheet private debt is compared against public market comparables. Across the industry 50-100 basis-point spread is a good rule of thumb in terms of compensation for additional liquidity and complexity risk taken.

Kapur responded that in a 5% rate environment Schroders still puts money to work. "Target rates haven't gone up 5%," he said. If rates go back down, you are where you were."

"But if rates move down, do you move to private equity?" asked Bora.

Moon replied that there was an important distinction to be made: "What is your mandate? Is the source of capital public credit or private equity? We have a flexible private markets mandate and have elected not to participate in equity co-investments when projected IRRs are at 19 or 20%. We can now lend to the same companies at 10-12%, which seems like better relative value. Generally, across private equity and private debt markets, there is lots of pent-up capital driving returns down."

McKnight saw a familiar phase in the cycle of private debt now becoming covenant-lite.

"You are paying more for the debt while gearing has gone down a bit," said Breban. "So you are not getting as much benefit from leverage. The maths do not add up."

"It comes back to valuations," said Kapur. "They have to adjust if rates stay where they are."

"Why are people not buying? The market is expecting a sell-off," said McKnight. "There is a huge amount of dry powder while things are just bumping along." He viewed pension funds as stepping back from their role as marginal buyers but expected sovereign wealth funds and family offices to pile in to the space opportunistically and have 'a field day'.

What does this mean for operations? As allocations to private markets continue to increase, Slattery said that investment managers and investors encounter challenges with managing data around private funds: "LPs struggle to retrieve, aggregate, validate and reconcile data received from GPs. Managers face challenges around storing documents, tracking commitments and accurately accounting and reporting on their funds."

Transparency is crucial to inform decisions. In the current environment, Moon said the contention was in the bid-ask spread. He saw would-be sellers of private equity holdings have lots of portfolio companies marked on their books at unrealistically high valuations.

Amid the stand-off, Bora noted that GPs had to create a liquidity or distribution valve for LPs.

Kapur noted the big PE firms have been successful for such a long period of time. His question was whether valuations reset violently or gradually.

Moon said the answer was gradually. "The passage of time enables portfolio companies to grow into their valuations through improved operational performance."

Kapur described it as a race against time. In the meantime, he saw continuation vehicles as one useful means of creating liquidity for LPs who want out - albeit they come with costs.

Bora asked who pays for the new vehicle. Moon replied there would be different reasons you may want to be on the buy side rather than taking liquidity, including raising alignment with the GP. He noted again that Railpen had the resources to do co-investment underwriting.

On liquidity, Moon distinguished market liquidity from distributions generated by GP-led initiatives such as NAV facilities and continuation vehicles. Market liquidity, e.g. the interest of trade buyers, is a way of ensuring LPs get the best price for selling.

Breban said that on the point of transfer of a company into the continuation vehicle, a GP can crystallise the carry. There is a risk that LPs lose out if the GP trousers a large part of the carry as part of a reset of the company's value.

Moon agreed that the GP rolling common equity into the CV and charging carry to new investors may create conflicts and change behaviours.

The panel then raised whether Limited Partner Advisory Committees (LPACs) would spot and minimise such behaviour.

Breban said that if you are actively engaged in a co-investment, you see things a bit earlier. His opinion was that most LPACs are an annual jolly without much teeth.

Kapur viewed LPACs differently. He said that there was a range of LPACs, with some demonstrating strong engagement.

> "*The passage of time enables portfolio companies to grow into their valuations through improved operational performance.*"

Orthogonally Attractive

Martin then asked about non-traditional forms of return. "Going forward, if I consider potentially investing in such alternative less liquid products, I ideally wish to see additionality and a different kind of return stream not related to equity or credit market beta," he said.

Five years ago, Railpen backed Generate Capital, a company that funds sustainable infrastructure assets in fast-growing sectors. "We are taking scale-up risk across multiple sustainable infrastructure sectors," said Moon. "We like the company structure; it ensures that management is well aligned with us through equity ownership and they have flexibility to deploy capital without the time-horizon or diversification constraints of a regular fund structure."

Martin said that he had found that some ventures involved with the energy transition were not great at communicating. "We need much better transparency on what they are holding. With some, asking for updates is like getting blood from a stone," he said.

McKnight described ESG as a cottage industry, with fleets of new entrants and advisers rushing to accommodate interest and demand in the space given the widespread press and attention it receives from the market, politicians and regulators.

Breban countered that there was room for optimism if the world gets incentivisation right. "We are not measuring properly yet," he said. "Where is the best environment for renewables? It's Texas! A state that actively supports and subsidises the oil & gas sector. But solar is still competitive there against the cheapest shale production in the world.

Slattery noted that the lack of uniformity and lack of transparency amongst private fund data, and especially ESG, requires a robust and flexible data management solution. Manual processes to address data aggregation, validation and reconciliation are still too often relied on, and lead to significant overhead and risks including manual error.

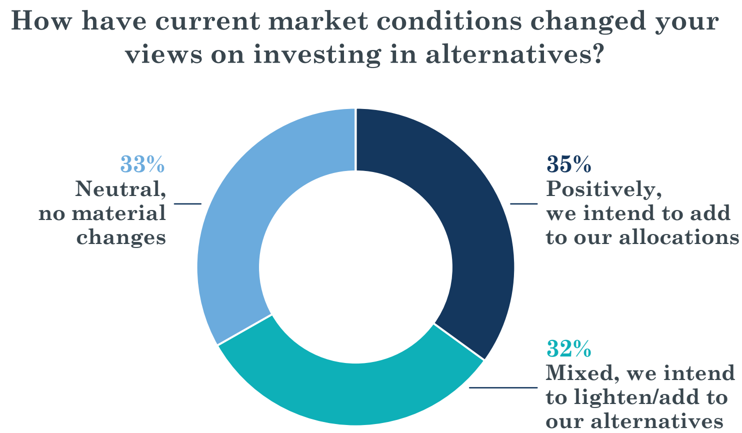
Slattery concluded the cio investment club roundtable by observing how increased transparency is being driven by retail investors and also by global ESG initiatives and net-zero commitments.

2024 State of Alternatives Study

Clearwater recently surveyed institutional asset owners and asset managers about their investments in alternatives, both today and looking forward, and received over 230 responses from clients representing over $10 trillion in assets under management (AUM).

Our 2024 State of Alternatives study reveals insights into the current state and future trends of the investment management industry. This study presents a comprehensive overview of the perceptions, strategies, and hurdles institutions face managing alternative investments.

Q: How have current market conditions changed views on investing in alternatives?

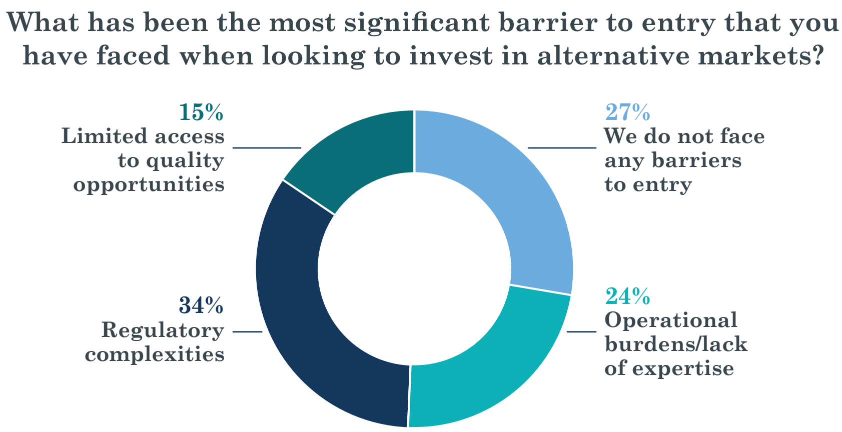


Investors continue to have an openness toward alternatives even in the face of increased scrutiny and global economic uncertainty. Our survey showed cautious optimism among investors.

Approximately 35% of investors hold favourable views of current market conditions and are planning to increase their investments in alternative assets. While some respondents shared a level of caution, with 32% of investors expressing mixed sentiments that may prompt reallocation strategies, and 33% of investors intend to maintain their existing stance. This suggests either contentment with current allocations or a strategic wait-and-see approach due to market volatility.

Q: What has been the most significant barrier to entry when looking to invest in alternative markets?

With responses indicating a continuation or increase in alternative allocations, we asked respondents what their most significant barrier to entry is when considering alternative market investments.



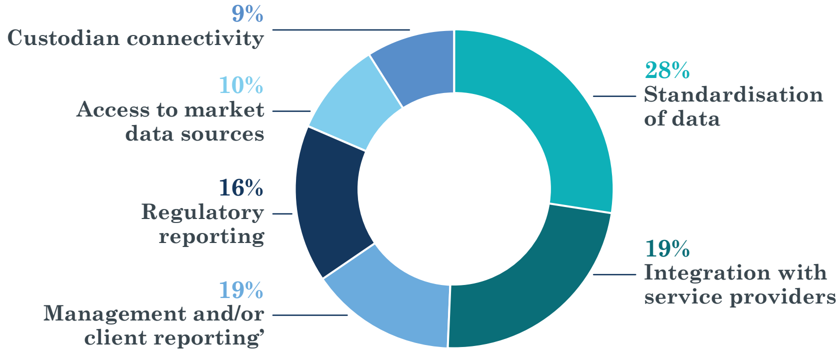
The fact that nearly a quarter of investors reported no barriers to entry suggests that many of these once "alternative" investments are now mainstream and investors are better equipped to handle these challenges.

Still, the responses tell a familiar story — navigating regulatory complexity and day-to-day operations continue to present the most daunting challenges for many investors getting into alternative investments. These insights underscore the urgent need within the financial community for more streamlined regulatory processes and operational efficiencies in alternative investments.

Q: Where is the most significant opportunity to improve operations to manage alternative assets?

Responses indicate a unanimous desire for progress across the board. A deep dive into the operational aspects of investment management reveals the need for enhanced data capabilities and portfolio analytics tools to better support alternative investment processes.

Where do you feel you have the most significant opportunity to improve your operations over alternatives?



Respondents singled out data standardisation as the primary focus for development, with over a quarter recognising it as a top priority. This was closely followed by the need for enhanced data integration with service providers, and improvements in management and client reporting. Access to market data sources and regulatory reporting were also noted as significant. Despite the prevalence of data concerns, only 8.6% of the respondents see a substantial need for fostering better custodian relationships.

Investors want technology solutions that can streamline data management and improve risk and exposure management, with 72% of participants identifying these improvements as critical to 2024 and beyond.

The Future of Alternative Investments Depends on Operational Efficiency

As this survey indicates, to thrive in the alternative investments market, the journey this year and beyond will rely heavily on operational efficiency – particularly in data management and technological innovation.

Read further insights from this study[1]

[1] https://clearwateranalytics.com/resources/polls/2024-state-of-alternatives-study/?utm_medium=paid-display&utm_source=cio-investment-club

BRIGHTWOOD

BALANCED ORIGINATION

CORE INDUSTRY EXPERTISE

TRUSTED PARTNER

CREDIT-INTENSIVE UNDERWRITING

RESPONSIBLE INVESTING

2010
inception

+$6BN
of AUM

50% / 50%
sponsor / non - sponsor

+275
borrowers

+$13BN
deployed

+50
professionals

+5%
employee and associated persons capital committed

EMAIL US
info@brightwoodlp.com

For More Information:

646-957-9525

https://brightwoodlp.com

810 7th Ave, 26 FL
New York, NY 10019

Learn More

As of March 31, 2024. This material is for information purposes only and does not constitute an offer to sell or the solicitation of an offer to buy any investment product for which Brightwood Capital Advisors, LLC ("Brightwood") or any of its subsidiaries provide investment advisory or any other services. Capital deployed and number of borrowers reflect data since the inception of Brightwood in 2010. Capital deployed includes leverage and the reinvestment of interest payments and proceeds. Capital committed by employees and associated persons reflects the aggregate of capital commitments across all Brightwood managed funds by Brightwood employees, associated advisors, value-add investors, and the funds' general partners. Brightwood is registered as an investment adviser with the U.S. Securities and Exchange Commission ("SEC"). Registration with the SEC does not imply a certain level of skill or training and does not constitute an endorsement by the SEC.

Participants

Peter Martin

Investment Officer, The Medical Defence Union

Peter is the Investment Officer for The Medical Defence Union and has been with the MDU since 2016. He has over 30 years' experience as a senior investment professional.

Prior to joining the MDU, Peter was head of manager research at JLT Employee Benefits and before this at Aon Consulting. Peter's investment research specialisms have included bonds, LDI and property.

He is currently a member of the Investor Committee of the Association of Real Estate Funds. He is a Fellow of the Institute and Faculty of Actuaries and also holds the Investment Management Certificate (IMC).

Ian McKnight

Outsourced Chief Investment Officer, Cartwright

Ian has over 25 years' investment experience advising pension schemes and charities on all aspects of their investment strategies. He notably ran the investments of Royal Mail's pension schemes for over 13 years as CIO, gaining a reputation for problem solving, innovation and achieving very strong results.

He has expertise in risk transfer, portfolio construction, manager selection and managing complex alternatives portfolios within a market leading governance structure.

RAILPEN

Richard Moon

Head of Private Markets, Railpen

Richard serves as Head of Private Markets at Railpen, one of the UK's largest and oldest pension funds. With 20 years of experience across a broad range of private markets.

Richard has practical expertise in due diligence across a range of private investment strategies, including private equity, private debt, venture capital, real assets, infrastructure, and commodities.

Schroders

Rohit Kapur

Head of Private Markets, OCIO, Schroders Solutions

Rohit is Head of Private Markets, OCIO at Schroders Solutions. He has 21 years' experience in investment management covering fund and security selection. He has worked as a fixed income portfolio manager at BMO as well as a senior credit research manager at Aon. For the past seven years, he has been responsible for private market investments for the Centrica Pension Scheme.

Rohit is a CFA charterholder, chartered accountant and has a BPharm (First Class) from the University of Nottingham.

Imran Bora

Portfolio Manager, Brightwood Capital Advisors

Imran Bora, CFA manages credit portfolios and strategic sourcing partnerships within Brightwood Capital Advisors, a 100% minority owned private credit firm investing in lower middle market companies in the US.

Previously, he was the Lead Portfolio Manager for $3.5B of separately managed account mandates of credit portfolios within Citizens Financial Group in Boston, United States. Imran has over 25 years of lending and investments experience and has deep expertise for portfolio construction and building credit businesses. Imran completed his MBA in finance from Boston University, is a CFA Charter Holder and a member of CFA Society of Boston. Imran is a resident of Boston, Massachusetts and is an avid marathoner.

BRIGHTWOOD

David Devlin

Director - Strategic Partnerships, Phoenix Group

David joined Phoenix from Scottish Widows where he was Head of Shareholder Assets. He was focussed on annuity fund investment strategy, asset manager and investment bank relationships, bulk annuity pricing/ proposition and new asset implementation.

David has also worked as a consultant in EY's Insurance Investment Team and has written multiple papers on private investment.

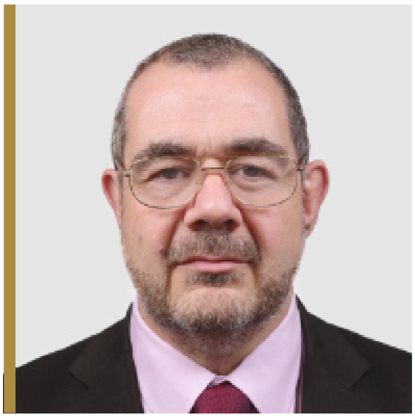
Phoenix

Brian Slattery

Head of Insurance EMEA, Clearwater Analytics

Brian Slattery has been with Clearwater since February 2011 and holds the title of SVP, Head of Insurance EMEA. He leads a team of insurance specialists to help drive efficient operations and partnerships with Clearwater's European clients. Brian possesses a strong understanding of prevalent market needs and has a successful track record helping many firms improve their overall investment portfolio processes. Brian previously served as SVP, Head of North America and was responsible for growth in the U.S. and Bermuda markets.

Brian is a former Lieutenant Commander in the United States Navy Reserve and was Honourably discharged after 11 years of service. He graduated from the US Merchant Marine Academy at Kings Point, where he was a collegiate All-American football team captain.



Stephan Breban

Head of Research, Renewity

30 years advising pension plans on private equity investment and GP/fund of funds selection.

Stephan started out with Bacon & Woodrow (now Aon) in London in 1988 covering private equity manager research and selection. After working for different larger pension plan consultants Stephan decided to strike out on his own to provide a conflict free service to institutional investors. Throughout his career he has advised pension plans, and other institutional investors, on a range of investment issues but, focused on private markets.

In attendance

Brendan Maton (Moderator)

Director, Crayford Ash

Brendan Maton has been covering pensions and investments as a journalist for almost thirty years. He began his career at FT Business before going independent in 2003. Since then, he has chaired roundtables, moderated investor conferences and hosted the IPE channel of sponsored webcasts. He still writes on pensions and investments for IPE as well as freelancing for a host of organisations.

Sean Thompson

Founder & Director, cio investment club

Sean has 38 years of experience working in London's financial services sector and the insurance market. After 10 years as Managing Director of CAMRADATA, Sean launched the cio investment club on 1st January 2024.

The cio investment club's mission is to become the voice of chief investment officers and investment professionals at institutional firms. To help achieve this the club hosts events throughout the year that educate and inform, whilst providing thought-provoking content to its members.

cio investment club