

THE CHANGING PENSION LANDSCAPE: DB VERSUS DC SCHEMES

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January 2020

Brian McMahon: A defined benefit scheme is a legacy product, and in such schemes, companies were responsible for the benefits that the pensioners got at their retirement.

On a defined contribution scheme, the onus is now on the members. They take responsibility for their end saving. The big difference for defined benefit and defined contribution is that defined benefit schemes have had access to private markets. Defined contribution schemes find it much harder to access those same markets.

Rob Barr: If you incorporated something like 7% of private equity into your multi-asset structure over a period of 45 years, somebody who is saving something like \$6,000 a year, could increase their savings pot at the point of retirement by as much as \$170,000 over the returns they would have got if they had just invested in equities and bonds.

PRIVATE VS PUBLIC MARKETS

Rob Barr: Amazon was founded in 1994, and it floated three years later, and the market cap was just over \$600 million.

Google floated in 2004 at a market cap of around about \$26 billion. And Facebook was founded at that point and rolled forward for eight years, and then it floated at \$110 billion market cap.

Amazon, the returns that could be generated for an investor who came at the IPO was something like 700 times to today. The return for a Google investor, something like 26 times, and for a Facebook investor, four times.

The real value to investors is being captured by the private markets, as opposed to the listed markets.

WHY AREN'T MORE DEFINED CONTRIBUTION SCHEMES INVESTING IN PRIVATE MARKETS?

Rob Barr: Defined contribution investments require, as an industry standard, daily liquidity and daily valuations. And that's very challenging.

Brian McMahon: When people invest in private markets - whether it's a company, whether it's infrastructure, whether it's real estate - you don't get a price for that every single day.

If someone's looking at wind farm, the value of the wind farm is linked to the electricity generation, the tariffs that are there. But that value tends to be a long-term value. They can't go in and buy one turbine.

So, therefore, we've worked with our clients to develop evaluation models that enable us to reflect that.

LIQUIDITY CHALLENGES

Rob Barr: There are challenges around liquidity in private markets, the cash coming in and out, so you're not faced with individuals withdrawing huge amounts of money at an awkward time in the market cycle.

Brian McMahon: To manage that, schemes are set up in such a way as they have both liquid and illiquid sleeves within it. They invest in some assets that can be sold easily and the other assets are held for long term.

Liquidity is often mentioned as the primary challenge, but equally valuation, the cost of running the schemes and the administrative burden that's associated with it, are quite important.

OVERCOMING CHALLENGES

Brian McMahon: In overcoming the challenges I think it is working with trustees, making sure that the business case for the investment is well understood and making sure that both understand how the liquidity pools will work.

Equally, I think it's important that in choosing an administrator, asset managers work with somebody that can cover the entire asset spectrum - whether it's real estate, private equity, infrastructure, private debt - you have to have confidence that the administrator has sufficient skills, depth, and technical know-how.

In BNY Mellon, we run a number of different programmes where we have built our infrastructure to allow for a cost-effective means of doing this. We run these funds daily, we value the assets daily, we combine the listed and unlisted assets.

THE FUTURE OF PRIVATE MARKETS

Rob Barr: One of the things that we're very proud of as a firm is that we set up an investment trust in 1987, investing in private equity. That investment trust has generated a return of 12% per annum since inception and now has an NAV of something in the region of £1.5 billion.

Brian McMahon: I think when people are looking at private markets, people have to look at where we've been and where we're going.

Whereas five years ago people may be asking "why are we invested in private markets?"

Today, they have to ask, "why not?"

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