



Could, would or should?

Will recent pledges from pension funds to allocate cash to private equity achieve anything, asks **Jon Moulton**

The UK chancellor Jeremy Hunt is anxiously casting around for ways to get growth and productivity going. One of his recently much-publicised approaches is to get defined benefit – and the progressively bigger defined contribution – schemes to put fixed percentages into ‘unlisted investments’, which basically means private equity. Politicians and journalists sometimes (but not in this publication) label private equity itself ‘high-growth investment’ or ‘venture capital’, conflating asset classes willy-nilly. You would hope they knew better, but often they don’t.

In July, nine of the UK’s biggest pension managers signed the Mansion House Compact aimed at diverting more money to unlisted equities – the promise is they will allocate 5% of their funds to unlisted equities by 2030. With a beaming Hunt overseeing the signing session, the government announced the reforms “could increase pensions by more than £1,000 a year in retirement for an average earner who saves over the course of a career”.

It is probably unrealistic to expect government to ignore the £2.5trn or so in assets these pension funds hold. And they will not. However, there are a lot of things wrong with its current approach.

The government makes a website claim that investing 5% into private equity “will” increase defined contribution funding pools by 12% over a lifetime of working. The Chancellor’s use of the word “could” is sensible. You could predict the Financial Conduct Authority’s deeply hostile reaction to anyone in the investment management industry making such bold claims. The assumptions for the calculation are not stated, but it seems from my own calculations that private equity is set to outperform by 4% pa compound for the next half century.

This is a pretty bold assumption. History mostly points to private equity outperforming listed stocks, but it is not hard to find historical periods where that has not been the outcome. Plenty of factors are different now. In large-scale private equity, the number of competitors has increased, targets are

more expensive and taxation worse than it was. Plus, increased regulation keeps arriving. And one day, in the next decade or two, it will be so large that it will have substantially filled the available market.

The reality

I fear the government only really sees private equity as white-hot technology, emerging with trumpets blazing from a glorious and world-leading start-up, based in a government-funded facility and in a marginal constituency. Sadly, private equity is largely about mature businesses that private equity thinks it can improve. Changes in ownership only make a marginal effect on growth. And workforce reduction is not uncommon.

And, of course, unlisted equities do not mean the UK – lots of any allocation will end up offshore to potentially do good there. Or, of course, do mediocre there, too.

The actual compact is to ‘allocate’ 5% of unlisted equities of the portfolio of default fund products ‘by 2030’. Cynical professionals will note this very precise language. I guess that the resulting, rather miserable, redirection of funds into domestic private equity will not keep the government happy. We will face forced investment into UK firms within years.

From a private equity industry viewpoint, the arrival of mountains of government cash mandated for UK deals will boost management fees. Of course, lots of cash will inevitably have to go into more marginal businesses and returns will tend to decline. That 12% increase in defined contribution funding pools would have to be forgotten.

Being extremely careful with my words – I want to state explicitly that while I am a member of two ICAEW bodies, these are my views alone and may not represent the views of these bodies or of the Institute more generally – but meddling with pension money is not what the government should be doing.

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