PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

PENSIONS & GROWTH: CREATING A PIPELINE OF INVESTABLE UK OPPORTUNITIES

AUGUST 2024

CONTENTS

ABOUT US

We are the voice of workplace pensions and savings and we represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures.

As the voice of workplace pensions and savings, we lead in bringing the industry together behind our shared aims. Across our work in policy development, advocacy, membership engagement, events and communications, we engage with over 2,500 organisations, with nearly 16,000 contacts within our membership and a further 17,000 in the pensions and financial services industries.

We aim to help everyone achieve a better income in retirement and we are committed to doing everything we can to improve the retirement incomes of savers in the UK. That means making sure they save adequately through their working lives, investing their money responsibly, ensuring the schemes they belong to can meet the highest standards, improving regulation so it works in the interests of our members and their members, and helping people to understand their options when they come to retire. We do this for, with and through our members.

EXECUTIVE SUMMARY

As is widely recognised, investments made by UK pension funds support our economic growth and are a major source of long-term investment in the UK economy.

An estimated £1 trillion of pension fund capital is allocated to UK-domiciled assets, for structural reasons the majority is deployed in government debt, other fixed-income assets and publicly listed companies.

Since early 2023, there has been considerable debate about whether and how pension funds can be encouraged to allocate more to emerging – and higher risk – opportunities that could drive UK economic growth.

In response, the PLSA identified six areas where either existing barriers could be removed or where pension funds might be incentivised or encouraged to allocate more to the domestic economy.

These actions included:

- **Pipeline of assets:** Ensuring there is a stream of high-quality investment assets suitable for pension fund needs.
- **DB regulation:** Introducing greater flexibility into the funding regime for private sector DB schemes, in particular for open DB schemes and those schemes with longer investment time horizons.
- **Taxation:** Introducing fiscal incentives for pension funds so that investing in UK assets is more attractive than investing in similar assets of other countries.
- **Consolidation:** Prioritising the passage through Parliament of a Bill to place DB superfunds on a statutory footing and carrying forward, in a pragmatic way, its current programme of measures related to DC Master Trusts and the LGPS.
- **Market for DC under automatic enrolment:** Taking a range of actions to encourage more focus on performance and less on cost, for example, the greater use of Value for Money tests and setting the right regulatory regime for advice to employers and schemes.
- **Raising pensions contributions:** Increasing the flow of assets into DC schemes by raising automatic enrolment contributions from 8% to 12% over the next decade.

Crucially, pensions funds have a fiduciary duty and will only invest where the risk-return characteristics of potential investments meet the needs of their members. Pension funds are not homogeneous and different types of pension schemes will have varying capacity to invest in higher risk assets.

DIFFERENT SCHEME TYPES HAVE DIFFERENT NEEDS

TYPE OF SCHEME	INVESTMENT CHARACTERISTICS
PRIVATE SECTOR DEFINED BENEFIT	The majority of the 5,000 DB schemes are approaching maturity and so will need investment in low volatility assets. A sizeable minority (c.500), managing £300 billion on behalf of millions of members, remain open to accrual. These open schemes have capacity to invest in a wide range of growth assets.
LOCAL GOVERNMENT PENSION SCHEME (LGPS)	The LGPS is the UK's largest funded public sector scheme. It manages over £400 billion of assets for its six million members. The scheme remains open to new members and accrual. Eight large asset pools managing c.£25-80 billion each have already been created in England and Wales. It has the potential to invest in growth assets.
DEFINED CONTRIBUTION	There are a wide range of DC schemes in the UK, ranging from very small retail personal pensions through to some medium sized, and some very large Master Trusts. The Master Trusts look after 20 million savers and around £120 billion. They are growing rapidly and will manage £1 trillion in assets by 2030. These schemes invest largely in equities and, as their scale grows, will have increased scope to invest in growth assets.

THE SIZE OF THE CHALLENGE

As the new Government seeks to reinvigorate the UK and stimulate growth, this report focuses on one of the PLSA's identified areas – the pipeline of investable assets – and makes practical recommendations to create the necessary investment conditions for pension schemes to allocate a greater portion of the nation's retirement savings to promising UK growth areas.

It also identifies a funding gap amounting to tens of billions of pounds across four key areas which most require investment.

- **Climate change:** In the UK, the Climate Change Committee's sixth carbon budget estimated that reaching net zero will cost ~£50 billion a year.
- **Infrastructure:** Analysis of the National Infrastructure and Construction Pipeline identifies a need for private investment in infrastructure between now and 2032/33. For example, energy sector investment of £33 billion.
- **Social and community growth funds:** Research into social housing shows the sector will require an average of £14.6 billion in capital grants from the Government each year between 2021-2031, to leverage enough private capital for a housebuilding programme worth a total of £46.2 billion per year on average.
- **Life sciences and AI:** Improvements are required to the investment ecosystem in these areas. With AI predicted to generate an additional £32 billion of revenue by 2030, there is substantial scope for expansion if the UK can incentivise it.

EXAMPLES OF REQUIRED ACTION BY SECTOR

Mobilising pension fund investment into UK productive finance has the potential to result in significant, tangible, real-world benefits for society. The table below reveals some of the actions needed to attract pension fund investment to key projects.

SECTOR	POTENTIAL BENEFITS	HOW TO MAKE THESE ASSETS MORE INVESTABLE
ENERGY	Investment in wind, solar and nuclear power would support decarbonisation and lead to estimated operational savings of **£50 billion** by 2050.	• Planning reform • Grid connection rule reforms • Use of contracts for difference • Revenue caps and floors • Better location signalling of battery sites • Smaller scale nuclear projects
HEAT AND BUILDINGS	Upgrading buildings to EPC C energy standards and scaling up the market for heat pumps could lead to cost reductions of **£5 billion** per year from increased efficiency.	• Revise incentive policy • Develop skills to speed up heat pump installation
LATER LIFE HOUSING AND SOCIAL CARE	Construction and improvement of necessary housing to **address demands of a rapidly ageing population.**	• Improve planning processes • Incentivise developments that cater to senior housing requirements • Provide certainty over state/private funding • Stable, long-term policy
SOCIAL HOUSING	Address the UK's social housing shortfall.	• Planning reform • Capital allowances for private investors • Lessons from US social housing tax incentive regime • Introduce long-term CPI-linked rent ceilings
TRANSPORT	Rail, shipping and aviation improvements, as well as adoption of electric vehicles can result in cleaner, **greener transport and economic growth** in better connected regions.	• Issuance of appropriate inflation-linked bonds to finance projects • Set a clear plan for improving local transport links • Cross-party commitment to projects to give investors certainty
ARTIFICIAL INTELLIGENCE (AI)	An acceleration in AI adoption and digital technology could add **£520 billion** to the UK economy by 2030.	• Develop investment eco-system • Provide incentives to offset inherent risks of investing in early-stage technology, e.g. LIFTS initiative or Government accepting 'first loss' risk • Facilitate blended finance solutions • Investment consultants to work with industry and Government to identify investment opportunities

NEXT STEPS

With Government, pension funds, investment managers, investee companies and consultants all playing their part, there is substantial potential to open the pipeline of assets to attract the investment of pension funds to support UK growth. This report makes specific recommendations for each of these groups (summary p. 12).

However, we highlight below our recommended actions for two of them: pension funds and the Government.

TRUSTEES AND PENSION FUNDS SHOULD:

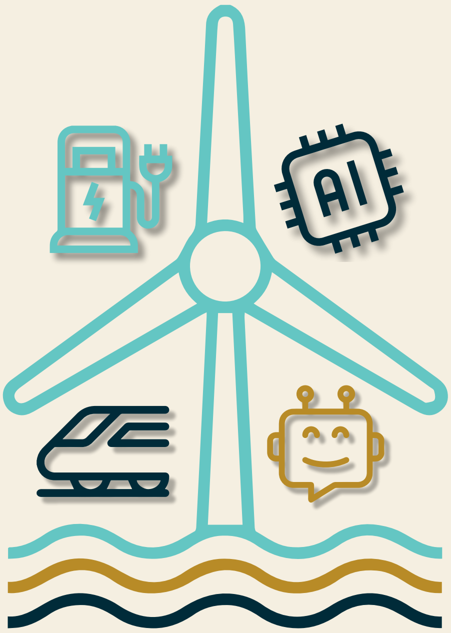
- **Develop investment strategies** that consider how to allocate to private market assets appropriately to meet the needs of the scheme and future liabilities.
- **Be aware that training may be required** to ensure there is an appropriate level of knowledge and understanding of social and climate issues and how to integrate these into investment decisions.
- **Encourage advisers and consultants to further consider growth assets in investment strategies** put forward for DB and DC schemes, and consider any gaps in service provider expertise.
- **Understand the risks involved** in different types of investments and how to effectively diversify their portfolio, including clarifying fiduciary duty so trustees are clear that climate considerations are compatible with their fiduciary duty.
- **Ensure Statements of Investment Principles clearly articulate trustee views** on which investment sectors to prioritise.
- **Consider what blended finance structures would make sectors more investable.**

WE CALL ON THE GOVERNMENT TO:

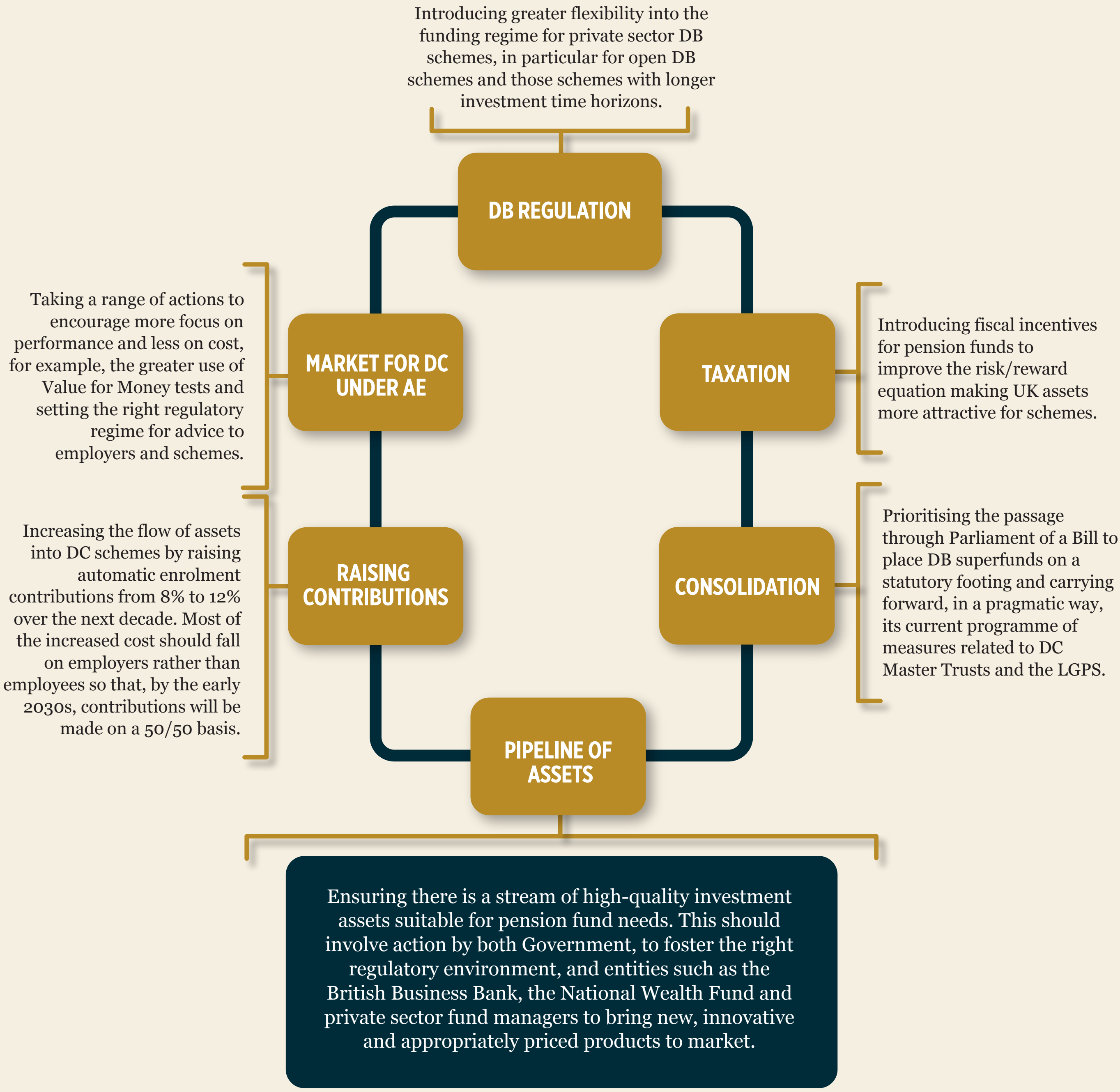
- **Provide policy and regulatory certainty** to improve the UK's appeal versus investment opportunities globally. This includes developing a long-term strategy for investment and growth, outlining the Government's priority investment sectors, its approach to blended finance and how it will work with the pensions industry.
- **Offer targeted fiscal incentives** to make UK growth assets more attractive than competing assets from other countries. Enhancing the tax treatment of domestic investments, as they do in France and Australia, merits further exploration. In addition, initiatives like LIFTS, which supports investment in UK start-ups and companies requiring late-stage growth capital should also be considered.
- **Expand the area of focus beyond private equity and venture capital** to encompass infrastructure, alternative assets and a variety of funding models.
- **Take control in bringing key industry groups together** to develop solutions to growth challenges.
- **Produce a plan for the development of skills** to achieve growth.
- **Lead and collaborate on AI and net zero** at international scale.
- **Continue to work closely with regulators** and others to get the right approach to investment risk, including DC, open DB and the LGPS, where this is in the interest of scheme members.
- **Deliver planning reform** to enable crucial energy, infrastructure, social housing and later life care development.

INTRODUCTION

As the new Labour Government seeks to reinvigorate the UK economy and stimulate growth, it is considering ways to encourage the £2 trillion[1] retirement savings sector to invest in UK assets. At the PLSA, we have reported extensively on what the pensions industry needs to support the ambition of successive Governments to invest in UK growth. At present, we estimate UK pension funds already invest over £1 trillion in the UK, spread across government and corporate bonds, equities, private debt, private equity, property and other alternative assets. For the Government to stimulate even greater financing of UK assets by pension funds, more needs to be done. Previous work by the PLSA, including a paper from June 2023 on Supporting Investment in UK Growth[2], our October 2023 Policy Statement[3] and a joint statement with the ABI[4] ahead of the Spring Budget articulate six actions for the Government to consider to encourage greater investment by pension funds in UK assets. These six actions are as follows:



1. Funded occupational pension schemes in the UK: April to September 2023, ONS, 2024, https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/fundedoccupationalpensionschemesintheuk/apriltoseptember2023
2. PENSIONS AND GROWTH A PAPER BY THE PLSA ON SUPPORTING PENSION INVESTMENT IN UK GROWTH, PLSA, 2023, https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2023/Pensions-and-Growth-Jun-2023.pdf
3. Policy position on Pensions and Growth, PLSA, 2023, https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2023/PLSA-policy-position-on-pensions-and-growth-October-2023.pdf
4. Four measures to boost UK growth through greater pension invetsment, PLSA & ABI, 2024, https://www.plsa.co.uk/Policy-and-Research/Document-library/Four-measures-to-boost-UK-growth-through-greater-pension-investment-PLSA-ABI-statement



The purpose of this report is to build on the 'pipeline of assets' action that we have previously identified. The report highlights specific sectors where there are potential assets for UK pension funds to invest to help address financing gaps across four key themes – climate, infrastructure, social and community, and life sciences and AI.

MAKING THE UK MORE INVESTABLE FOR PENSION FUNDS

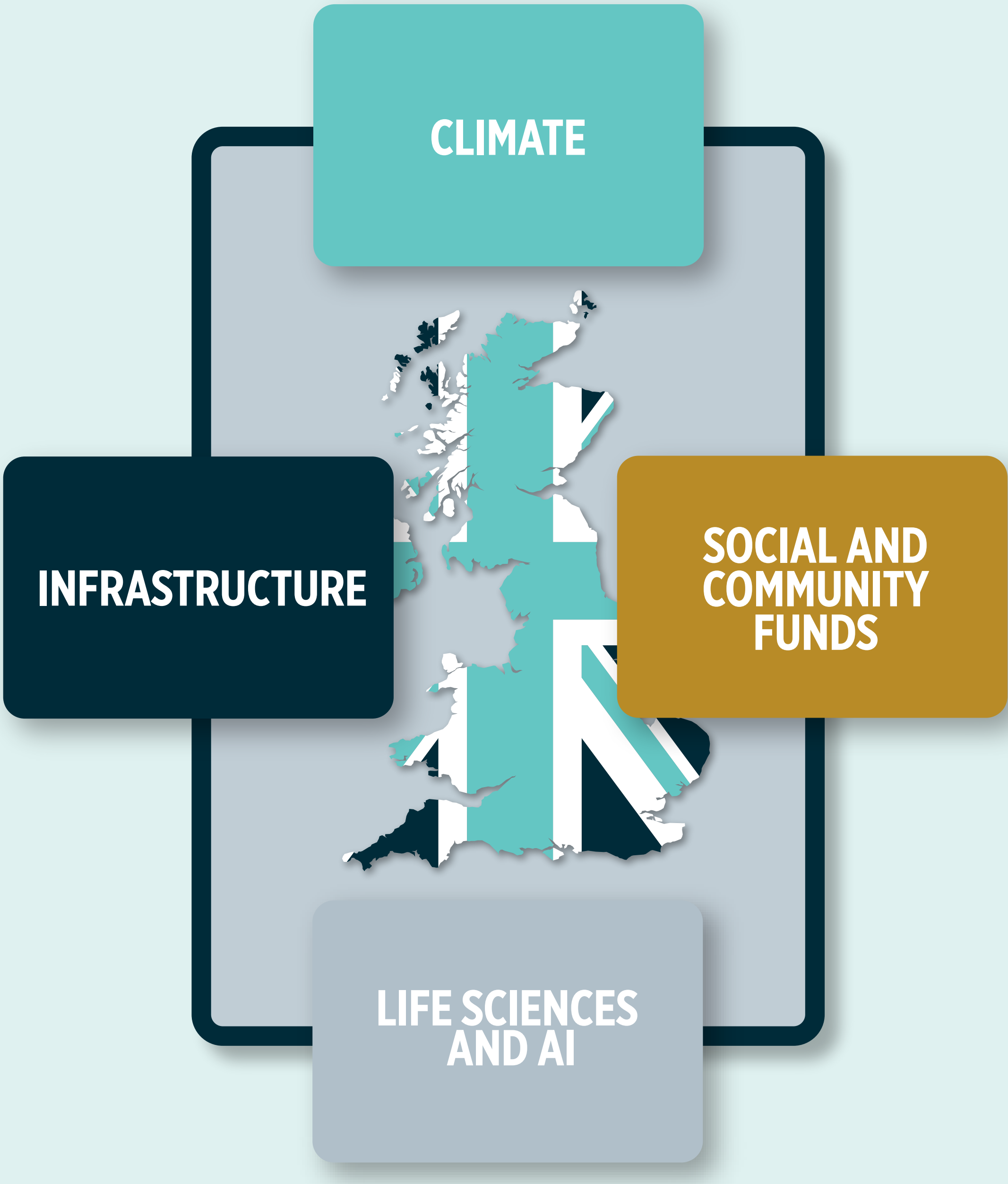
This report sets out some key sectors across the breadth of the UK economy which need investment and analyses these in the context of the investment characteristics which pension funds need to allocate capital.

A literature review has identified climate, infrastructure, social and community funds, life sciences and AI as priority investment themes for Government, think tanks and business. Therefore, these sectors should be targeted when considering policy interventions that might encourage growth.

Of course, pension funds can and should invest in sectors other than those identified in this report. But investments in climate, infrastructure, social and community and life sciences and AI can contribute significantly to growth and stimulate and maintain a thriving, diverse, fair and net-zero orientated economy in a way which works for pension funds.

UK funded workplace pensions are split between defined contribution (DC), defined benefit (DB - open and closed) and Local Government Pension Schemes (the LGPS). These schemes are run in very different ways, with different membership demographics, divisions of liability, risk appetites, and very different long-term objectives and strategies. Therefore these different perspectives and strategies must be considered when thinking about what may, or may not, be a suitable investment for a given scheme.

What all these categories have in common is the fiduciary duty those running the schemes have to their members. The maintenance of fiduciary duty is vital, as it dictates that investments must only be made in the best interests of scheme members. Investment in UK growth is entirely compatible with the continuation of investment freedom and fiduciary duty. But, for trustees and managers to allocate funds to any asset, **they need to offer attractive risk-adjusted returns net of fees.** While schemes do, of course, have obligations to consider wider factors, such as environmental, social and governance issues, **these alone do not constitute a strong enough investment case.**



This report breaks down the key attributes that different types of schemes require from their investments, and evaluates these needs alongside the potential assets available across the four key themes identified. It is only by accounting for the needs of investors that we will be able to drive the initial investment needed to kickstart what could become a virtuous circle of continued investment and growth.

THE ROLE OF KEY ACTORS IN DELIVERING UK GROWTH

This report reflects on what the pensions industry needs to consider when looking at potential assets and their viability. It also looks at the specific actions that need to be taken by key actors across the themes identified. The Government, pensions schemes, asset managers, investee companies and consultants must be aware of some issues which should be addressed to support the pensions industry.

GOVERNMENT

WE CALL ON THE GOVERNMENT TO:

- **Provide policy and regulatory certainty** to improve the UK's appeal versus investment opportunities globally. This includes developing a long-term strategy for investment and growth, outlining the Government's priority investment sectors, its approach to blended finance and how it will work with the pensions industry.
- **Offer targeted fiscal incentives** to make UK growth assets more attractive than competing assets from other countries. Enhancing the tax treatment of domestic investments, as they do in France and Australia, merits further exploration. In addition, initiatives like LIFTS, which supports investment in UK start-ups and companies requiring late-stage growth capital should also be considered.
- **Expand the area of focus beyond private equity and venture capital** to encompass infrastructure, alternative assets and a variety of funding models.
- **Take control in bringing key industry groups together** to develop solutions to growth challenges.
- **Produce a plan for the development of skills** to achieve growth.
- **Lead and collaborate on AI and net zero** at international scale.
- **Continue to work closely with regulators** to encourage schemes (predominantly open DB and LGPS) to take more investment risk (when it is appropriate to do so).
- **Deliver planning reform** to enable crucial energy, infrastructure, social housing and later life care development.

TRUSTEES / PENSION FUNDS

TRUSTEES AND PENSION FUNDS SHOULD:

- **Develop investment strategies that consider how to allocate to private market assets appropriately** to meet the needs of the scheme and future liabilities.
- **Be aware that training may be required** to ensure there is an appropriate level of knowledge and understanding of social and climate issues and how to integrate these into investment decisions.
- **Encourage advisers and consultants to further consider growth assets in investment strategies** put forward for DB and DC schemes, and consider any gaps in service provider expertise.
- **Understand the risks involved** in different types of investments and how to effectively diversify their portfolio, including clarifying fiduciary duty so trustees are clear that climate considerations are compatible with their fiduciary duty.
- **Ensure Statements of Investment Principles clearly articulate trustee views** on which investment sectors to prioritise.
- **Consider what blended finance structures would make sectors more investable.**

ASSET MANAGERS/ PE FIRMS

WE WANT ASSET MANAGERS AND PRIVATE EQUITY FIRMS TO:

- **Work with pension funds** to identify which sectors are most investable for the pensions industry and deliver on their investment objectives.
- **Be aware and educate pension funds that investable and potential assets will vary by scheme type.** The approach of asset managers should be tailored accordingly.
- **Consider scheme requirements,** e.g. more regular valuations, and tailor funds to cater for pension- specific requirements.
- **Be alive to the risk of greenwashing** and actively take action to address the challenge.
- **Utilise their voting powers** to bring about change that aligns with the principles and objectives of the scheme they represent.
- **Offer greater fee transparency.**

INVESTEE COMPANIES

INVESTEE COMPANIES MUST:

- **Work closely with the Government** to ensure that the necessary jobs, skills and industries develop to meet their needs.
- **Embrace the innovation that is required for net zero** across each sector and be at the forefront of this whether it is designing efficiencies for surface transport solutions, working to develop more environmentally friendly cement in construction or research to develop sustainable aircraft and aviation fuels.
- **Articulate what incentives they want to see** to make the UK an attractive proposition. It is vital that they are engaged to be part of the solution if we are to attract the necessary investment into the UK.

CONSULTANTS

CONSULTANTS WILL BE VITAL IN THEIR INTERACTIONS WITH ALL OF THE ABOVE KEY PLAYERS. THEY WILL CUT ACROSS PUBLIC AND PRIVATE SECTOR AND HAVE A PIVOTAL ROLE FOR THE INVESTMENT STRATEGIES OF ALL SCHEME TYPES. THEY SHOULD:

- **Work with asset managers and pension funds** to identify which sectors have the greatest need for investment by pension schemes.
- **Offer specific expertise** across a range of areas to be utilised by asset managers and owners alike.
- **Be FCA supervised** given the influence they have in investment decision making. Increasing consultant skills and expertise on priortity ESG factors will be vital in giving schemes the confidence to invest to meet these objectives.
- **Give greater consideration to non-standard investment strategies** put forward to clients, e.g. options for growth where a DB scheme chooses to run on and utilise surplus.
- **Be engaged early** given they are likely to be at the forefront of emerging technologies e.g. on carbon capture, or application for hydrogen usage.

THE SCALE OF THE INVESTMENT CHALLENGE

CLIMATE

In the UK, the Climate Change Committee's sixth carbon budget[5] estimated that reaching net zero will cost ~

£50bn

a year whilst figures from the Net Zero Strategy: Build Back Greener[6] suggest that an estimated **£55.5-71 billion** will need to be found each year throughout the late 2020s and into the 2030s.

International Energy Agency (IEA) estimates[7] that to reach net zero emissions by 2050, worldwide investment will need to more than triple by 2030 to around **$4 trillion** a year.

INFRASTRUCTURE

Analysis of the National Infrastructure and Construction Pipeline[8] identifies significant scope for private investment in infrastructure between now and 2032/33.

Energy sector
£33 billion

Social infrastructure
almost **£19.5 billion**

Transport
almost **£5.5 billion**

Broadband/communications
almost **£4.1 billion**

Other economic infrastructure
over **£1.3 billion**

All of this is with

£700-775bn

worth of projected/planned infrastructure spend already anticipated.

SOCIAL AND COMMUNITY GROWTH FUNDS

SOCIAL HOUSING

Research shows UK social housing need will require an average of

£14.6bn

in capital grants from the Government each year between 2021-2031 (£12.8 billion per year in today's prices), to leverage enough private capital for a housebuilding programme worth a total of £46.2 billion per year on average[9].

TRANSPORT

In scrapping parts of HS2, the previous Government announced

£36bn

for Network North as part of an approach to unlock local priorities and invest in improving local transport links.

5. Sixth Carbon Budget, Climate Change Committee, 2020, https://www.theccc.org.uk/publication/sixth-carbon-budget/
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8. Analysis of the National Infrastructure and Construction Pipeline 2023, Infrastructure and Projects Authority, 2024, https://assets.publishing.service.gov.uk/media/65bb86d7cc6fd600145dbe3e/Analysis_of_the_National_Infrastructure_and_Construction_Pipeline_2023.pdf
9. Capital grant required to meet social housing need in England 2021-2031, National Housing Federation, 2019, https://www.housing.org.uk/resources/capital-grant-required-to-meet-social-housing-need-in-england-2021-2031/

SOCIAL CARE

Net local authority expenditure[10] on adult social care in 2022/23 was

£20.5bn

However, in total in 2022/23, including the previous Government's planned spending on social care services by the NHS (of £4 billion), the total net public expenditure on adult social care in 2022/23 was around £24.5 billion.

For context, in 2021/22, 1.98 million adults applied for support with only 818,000 receiving some form of long-term care (around 43%)[11].

Whilst estimates vary based on methodologies used, the social care funding gap is huge. With increasing demand for social care and an increasing cost of delivering social care, it is expected that between **£7 billion**[12] and **£18.4 billion**[13] of additional spending will be required.

If the Government can find ways to work in partnership with the pensions industry there are a range of potential assets that can deliver good outcomes for communities in a way that also delivers pension schemes with financial returns.

LIFE SCIENCES AND AI

AI

Since 2014, the UK has invested over

£2.5bn

in AI with the intention of making the UK an AI powerhouse. AI suppliers added £3.7 billion to the UK economy and attracted nearly £19 billion in private investment through 2022[14].

The UK accounts for

48%

of Europe's AI funding. With AI predicted to generate an additional **£32 billion** of revenue by 2030, there is massive scope for expansion if the UK can incentivise it.

LIFE SCIENCES

The UK has a

£94bn

Life Sciences sector which saw £1.8 billion of venture capital investment in 2023[15].

The previous Government made a series of significant interventions to improve the availability of capital.

It provided **£200m** in funding through the Life Sciences Investment Programme. In addition, through the UK-UAE Sovereign Investment Partnership, Mubadala has made an **£800m** commitment to investment in the UK Life Sciences sector[16].

In 2023, **£17 million** of Government funding was announced to unlock a further **£260 million** of private capital through the Life Sciences Innovative Manufacturing Fund (LSIMF)[17].

Whilst good progress, the amounts are small when compared to the size of the industry. The Government will need to do more to develop the strength of UK public markets and set out a clear plan for facilitating long-term finance with innovative blended finance models.

10. Local authority revenue expenditure and financing England: 2022 to 2023 - third release, DLUHC, 2024, https://www.gov.uk/government/statistics/local-authority-revenue-expenditure-and-financing-england-2022-to-2023-third-release
11. Key facts and figures about adult social care, The Kings Fund, 2024, https://www.kingsfund.org.uk/insight-and-analysis/data-and-charts/key-facts-figures-adult-social-care
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14. The State of AI in the UK 2023: Trends, Data, Statistics, and Insight, Investing Strategy, 2023, https://investingstrategy.co.uk/financial-news/the-state-of-ai-in-the-uk-2023-trends-data-statistics-and-insight/#:~:text=The%20CBI%20report%20indicates%20that%20digital%20technologies%2C%20including
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17. Life sciences companies supercharged with £277 million in government and private investment, HM Government, 2023, https://www.gov.uk/government/news/life-sciences-companies-supercharged-with-277-million-in-government-and-private-investment

KEY INGREDIENTS FOR INVESTMENT IN TARGETED GROWTH AREAS

To encourage pension fund investment in targeted sectors, the Government should consider the following ingredients:

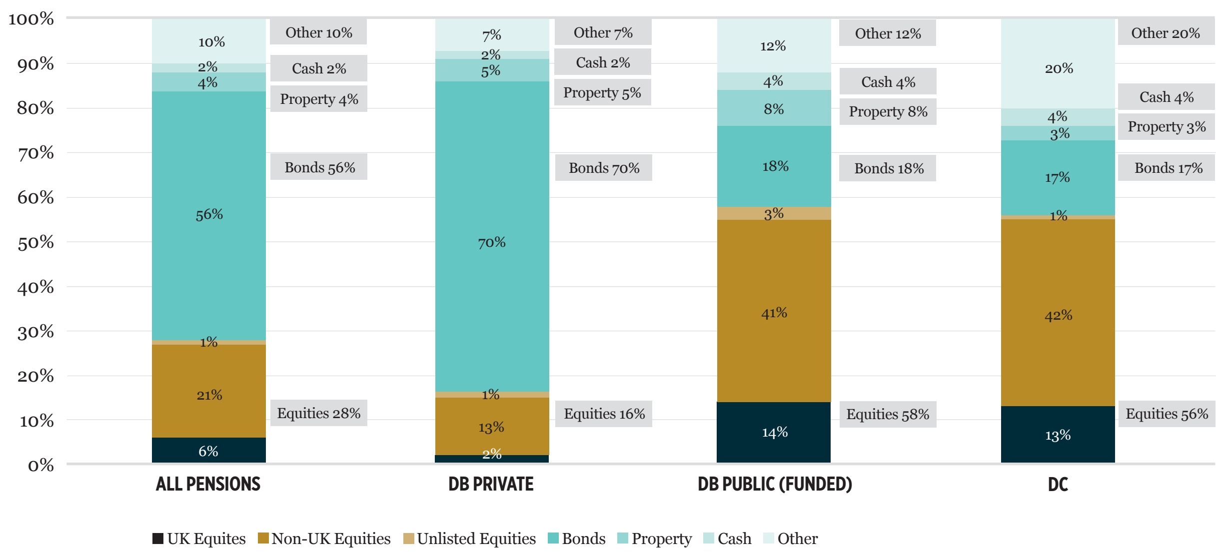
- **Policy certainty:** Political and regulatory uncertainty, as well as low growth, have reduced the UK's appeal when measured against global opportunities for investment. Setting out and implementing a clear plan for the future of the UK economy, for example regarding the Green Transition or in relation to an industrial strategy, will aid the return of confidence to UK markets. Policies are needed which allow industry to develop solutions for the long term; a good example of this is Long Term Asset Funds.
- **Fiscal incentives:** There has been a lack of additional support from Government for investment in the UK, in terms of fiscal incentives, e.g. tax or other treatment. The LIFTS initiative is a good example of an incentive that should work well as it alters the risk-reward calculus, including through pari passu co-investment and fee offset structures. However, greater scale will be needed to drive progress.
- **Expand the area of focus beyond private equity and venture capital:** The public debate about how to drive greater pension fund investment in UK growth has focused almost entirely on private equity and venture capital. However, with interest rates now higher than we have seen in the last decade and a half, alternative structures, such as private debt, could pose a more stable and attractive investment proposition for pension funds. Examples are provided later in this report.
- **Approach to blended finance:** The Government is looking to the pensions industry in particular to help meet its funding needs across a range of sectors. Clarity on how the Government intends to approach blended finance, including on the structure of blended finance funds and their governance, would be welcomed by pension funds.

INVESTMENT NEED DIFFERS BY SCHEME TYPE

PENSION FUND TYPES, MEMBERSHIP, NUMBER OF SCHEMES, AND ASSETS TODAY AND BEYOND

TYPE	NO. OF MEMBERS	NO. SCHEMES	AUT 2020	AUM 2030	TYPICAL MATURITY OF SCHEME
DB	12 million	5,000 (Closed: 4,500) (Open: 500)	£1.5 trillion (Closed: £1.2 trillion) (Open: £300 billion)	£1.5 trillion	10-15 years
DC	20 million	30 MTs & 1,000 PFs (>1,000 members) 1,100 GPPs (>1,000 members)	MT & PF: £435 billion GPPs: £170 billion	£955 billion	30-100 years
LGPS	6 million	100 pension funds & 8 asset pools	£270 billion	£500 billion	30-100 years

ASSET ALLOCATION



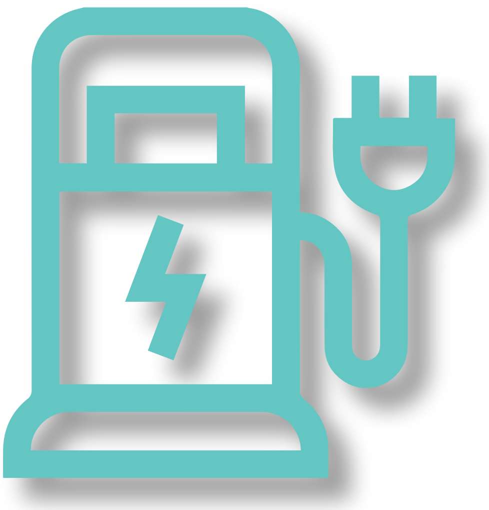
As is clear from the chart above, typical asset allocations vary between DB, DB public (LGPS) and DC schemes. This is because each has a different structure and different member objectives when it comes to providing its members with the best possible pension provision. Schemes which have a large proportion of deferred and pensioner members requiring a regular income in retirement (private and predominantly closed DB) will typically see value in assets that return regular (mainly inflation-linked) cashflows in order that they can meet those regular and ongoing liabilities. Therefore, gilts and corporate bonds, which are generally seen as low-risk assets which return a regular yield, are held in large quantities by these schemes.

For DC schemes, on the other hand, investment growth over the course of a member's career is the primary objective, and for pots to be as large as possible at retirement. While most will implement a de-risking strategy, typically in the 10 years before that point, for most of a member's working life, funds will be invested in higher risk assets with the potential for growth. The caveat, however, is that because members take all the investment risk in these schemes, there is a 0.75% charge cap, and the market overall is highly cost constrained due to tight competition. Therefore, emphasis tends to be on low-cost equities in passive funds and a focus on cost rather than performance.

Open DB schemes, notably the LGPS, can also invest more in growth assets as the need to match cash flows from assets to pension payments is less than for closed schemes. As such, its investment strategy more resembles that of DC in terms of risk. Collective DC schemes, in future, might have a similarly aggressive investment strategy, with pooling of risk and longer investment horizons enabling greater allocations to less liquid assets.

It is also worth noting that different types of assets are accessed in different ways, and that trustees' selection of investments will need to factor in structural elements. Partnership structures, the traditional route into illiquid assets, are complex to enter, requiring considerable governance and cost, so alternative vehicles, such as Long Term Asset Funds (LTAFs), which offer more flexibility for DC, will be an important consideration as schemes seek to allocate more funds to these assets.

Below, asset allocations and characteristics by scheme type are explored in more detail to outline the types of investments which may be suitable for each. Understanding that each type of scheme has varying needs and should be treated differently will be vital in creating the conditions to encourage pension fund investment in UK growth.



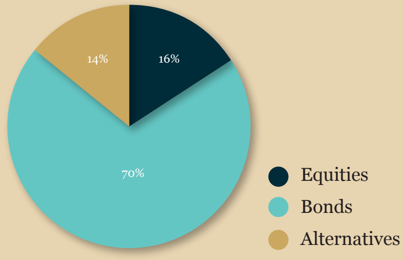
DB – PRIVATE SECTOR OPEN

ASSETS UNDER MANAGEMENT

- 462 open DB schemes with £240.6 billion AUM[18].

TYPICAL ASSET ALLOCATION AT PRESENT

NB – this breakdown reflects all private DB schemes. We do not have a breakdown of DB private sector open, versus DB private sector closed schemes. Open DB will have a higher allocation to equities and alternatives.



SCHEME OBJECTIVES – AND ASSET ATTRIBUTES TO MEET THESE

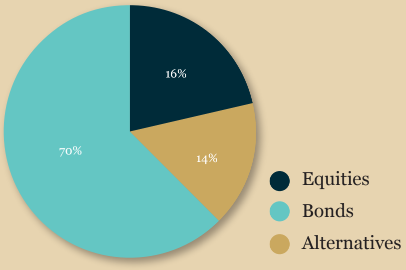
- Open DB schemes are accruing new liabilities and have younger members, some distance from retirement. Therefore, they can have a greater risk appetite for more growth-orientated assets and depending on scheme objectives and the plans of the corporate sponsor, some exposure to private equity and venture capital might be possible, especially as these schemes do not have the same commercial cost pressures and charge capping as DC.
- Most DB schemes that are still open to accrual and new members are with very large employers (or groups thereof). The scale these schemes have will mean many have access to co-investment options to access illiquid assets with less cost/risk.
- It is certainly likely to be the case that DB schemes which are open to future accrual and new members will be attracted to supporting the Government objectives for investing in growth over time. This is even more the case for the 10% of DB schemes which are open to new members.
- DB schemes open to new accrual currently make up around 50% of DB schemes. By 2035, this group may be closer to 20% (as more DB schemes close), so this demonstrates that it will be challenging to get much impact from DB as time goes on. The 10% open to new members are plausibly highly committed to maintaining a fully open DB scheme.
- With current strong funding levels there will be a mix of attitudes to private equity and other riskier assets. There is a clear opportunity for schemes running-on to take more risk and target more growth, while others will see any surplus as an opportunity to buyout and remove the scheme from balance sheets.
- Investments of sufficient quality can be expected to attract investors. But it is evident that the narrative of regulators can affect investment appetite. There seems to be a regulatory preference for investment in predominantly gilts, but not much else. This can mean that well-funded schemes are pushed towards being risk averse with limited exposure to illiquid assets. This regulator caution leads trustees to focus on hedging the valuation methodology rather than hedging the actual liabilities or seeking to deliver better outcomes by taking more investment risk.

SPECIFIC EXAMPLES

- Renewable energy assets, e.g. wind farms, offer regular cashflows over a long period which are well aligned with DB and LGPS liabilities. However, the cashflows on offer from these assets are currently low, largely due to government-dictated contract pricing, compared with bond/gilt yields.
- In relation to wind farms, Government sets the strike price for the contract for difference, and these are far lower than in the past, so there are few new pension investments in these assets; where pension schemes are invested, these were typically agreed at a higher price some years ago.

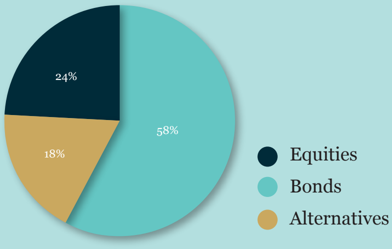
18. The Purple Book 2023: DB Pensions universe risk profile, Pension Protection Fund, 2023, https://www.ppf.co.uk/-/media/PPF-Website/Public/Purple-Book-Data-2023/PPF-The-Purple-Book-2023.pdf

DB – PRIVATE SECTOR CLOSED

ASSETS UNDER MANAGEMENT	• £1.5 trillion (DB open and closed combined). • 1814 schemes which are closed to new members with £685.1 billion AUM. • 2641 schemes which are closed to new benefit accrual with £463.5 billion AUM. • 134 schemes winding up with £15.2 billion AUM[19].
TYPICAL ASSET ALLOCATION AT PRESENT	
SCHEME OBJECTIVES – AND ASSET ATTRIBUTES TO MEET THESE	• Closed DB schemes vary between those which are not taking on new members but are open to accrual for existing members, and those closed to all new accruals. • Overall, these schemes, especially the latter, are taking on no additional liabilities and are gradually running off as they pay incomes to pensioners. • Their long-term objective may be self-sufficiency and to run off entirely, or to wind up and buy out with an insurer. As such there is a heavy reliance on fixed-income and liability-driven investments, including index-linked gilts and corporate bonds. Additionally, when considering what opportunities are available to them, the future liquidity of assets is a major consideration and closed DB schemes would not invest in assets without a clear exit plan and understanding of how attractive it might be to insurers. • Growth-orientated investments, structured to provide those incomes, would however be of interest to schemes. These might potentially include long-term bonds with yields above gilts, issued by NHS trusts to fund new hospitals, or by registered social housing providers, to provide social housing. • Given most DB schemes are now in surplus, both self-sufficiency and buyout are within reach for them, so there is therefore little incentive to take on additional investment risk for either trustees or the corporate sponsor. Priorities therefore include income-yielding assets which meet cashflows due to pensioners, with inflation protection a key priority. **Therefore, portfolios will be made up largely of index-linked gilts and corporate bonds.**

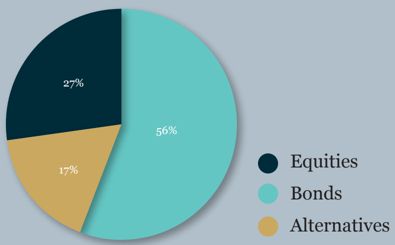
19. The Purple Book 2023: DB Pensions universe risk profile, Pension Protection Fund, 2023, https://www.ppf.co.uk/-/media/PPF-Website/Public/Purple-Book-Data-2023/PPF-The-Purple-Book-2023.pdf

LGPS

ASSETS UNDER MANAGEMENT	£425 billion.
TYPICAL ASSET ALLOCATION AT PRESENT	 The LGPS Scheme Advisory Board (SAB) Annual Report 2023[20] provides a more detailed breakdown of LGPS allocation: • Public equities – 51% • Bonds – 12% • Property – 8% • Infrastructure – 6% • Private equity – 6% • Multi-asset credit – 4% • Private debt – 3% • Unclassified – 2% • Diversified growth funds – 2% • Cash – 2% • LDI – 1% • Hedge funds – 1%
SCHEME OBJECTIVES – AND ASSET ATTRIBUTES TO MEET THESE	• LGPS funds' investment strategies resemble those of open private DB schemes, so their priorities for investment are assets which meet the long term: capital growth with inflation-linked incomes. • This similarity with open private DB schemes can put them in a better position to take more investment risk. Though it should be noted that with the majority of the LGPS funds in surplus, there is a question around whether they want, or need to take greater risk. • With most of the LGPS well en route to being fully funded (or in some cases, in surplus), the approach may change as some may become less willing to increase risk which is likely to conflict with the Government's enduring drive towards more 'productive' assets. • As we will come on to later in the report, there is a strong precedent for LGPS funds investing successfully in private markets.
SPECIFIC EXAMPLES	• Renewable energy assets, e.g. wind farms, offer regular cashflows over a long period which are well aligned with DB and LGPS liabilities. However, those cashflows may offer unattractive rates when compared with bond/gilt yields depending on contract for difference energy prices. • LGPS funds already allocate to private equity and debt (see Gravity Loan case study on p.29). • Real estate and social housing could offer similar returns in terms of regular income. However, planning rules can make these projects difficult and costly to initiate, while the certainty of income is less reliable than gilts and bonds.

20. Scheme Annual Report 2023, The Local Government Pension Scheme Advisory Board - England and Wales, 2024, https://lgpsboard.org/index.php/scheme-annual-report-2023

DC

ASSETS UNDER MANAGEMENT	£550 billion.
TYPICAL ASSET ALLOCATION AT PRESENT	 This average DC asset allocation is slightly skewed by DC schemes that are in the de-risking phase who are holding significantly more cash. If we consider the PPI's DC future book 2023[21], asset allocation of DC schemes 20 years before retirement, who are able to take more risk in their investments, we see: • 68% in equities • 14% in bonds/gilts • 3% in infrastructure • 4% in real estate • 3% (total) in private equity / private debt / venture capital
SCHEME OBJECTIVES – AND ASSET ATTRIBUTES TO MEET THESE	• In the growth phase, capital growth is the primary aim for DC schemes. **Higher growth assets might include equities, infrastructure, real estate, private credit, private equity and venture capital.** • In terms of duration, DC investments are held for many decades, which affords a long investment horizon. This horizon could be even longer, as there is increased in-scheme decumulation. **Therefore, private assets, real estate, and infrastructure investments, which often require investors to lock capital up for 5-10 years, are suitable.** • Trustees' fiduciary duty dictates they must invest **in the best interest of their members.** Typically, they see better returns coming from overseas assets, rather than UK. • Most savers are defaulted and remain in the default fund so risk levels need to be closely monitored with good governance. • **Government incentives which seek to cover some element of losses (therefore making the assets less volatile) could provide a further option to open up riskier private assets to DC investors, and there is some precedent in the LIFTS initiative.**

21. The future book 2023, PPI (In association with Columbia Threadneedle Investments, 2023, https://www.pensionspolicyinstitute.org.uk/media/xfybvxtq/20230926-the-dc-future-book-9-2023.pdf

DC (CONTINUED)

SCHEME OBJECTIVES – AND ASSET ATTRIBUTES TO MEET THESE	• DC schemes are subject to the 0.75% charge cap, and the market is very competitive on price (most are competing at 0.4%). Therefore, the preference is for large allocations to lower cost, passively managed funds. Any single high-cost asset or fund can skew the overall charge, and in the case of a master trust, make it uncompetitive. **Passive equity funds tend to be the cheapest route to investment growth.** • Many DC schemes prefer not to pay the performance fees associated with certain illiquid assets, such as private equity or venture capital. While performance fees can be excluded from the charge cap, fixed-fee elements can still be high, and fair distribution of variable performance elements between different members is a challenge. **Options to mitigate high fees are typically limited to larger schemes. Some schemes negotiate performance fees out of the arrangement, while co-investment agreements can allow blending of the fee with direct holdings in the same asset (or company) outside of the fund, reducing the fee overall.** • Currently, DC schemes provide daily pricing of their holdings, and therefore there is a preference for assets which are valued on a daily basis. There is an increasing acceptance, however, that larger schemes should have the capacity to invest small allocations to less liquid private equity and venture capital, which are typically valued on a quarterly basis.
SPECIFIC EXAMPLES	• A key asset type under our climate change theme is renewable energy. Different stages of renewable infrastructure projects offer different investment outcomes. The initial development stage of a renewable energy project can offer investment growth before the project is even up and running albeit with some level of risk (such as planning rules make such initiatives complex and costly). This phase may therefore suit DC investors, while the later phase, which is more associated with a regular income (in the form of energy prices) would be a better fit for DB or LGPS funds. • Our third theme in this report is AI and life sciences. Much of the innovation in these sectors comes through early-stage businesses, which the previous Government was keen to encourage to grow in the UK. With the potential for investment growth over the long term that private equity and venture capital funds offer, DC investors are well suited. However, incentives to overcome the cost and risk barriers are likely needed to enable a meaningful uptick in allocations.

CLIMATE CHANGE & INFRASTRUCTURE

The themes of climate change and infrastructure present a range of potential assets for investment. For pension funds, infrastructure investments that are net zero aligned and seek to deliver on the UK's commitment to achieve net zero by 2050 are likely to be favourable. This section will start by drawing out the scale of the challenge across climate and infrastructure before considering some of the most pertinent areas of investment need.

CLIMATE CHANGE – KEY FIGURES[22]:

NET ZERO & ENERGY SECURITY
£50-60 billion per year

NATURE
£500 million to £1 billion per year by 2030

CLIMATE ADAPTATION & RESILIENCE
£5 billion per year, likely to need to rise to £10 billion

TOTAL: £50-£70 BILLION PER YEAR

22. Mobilising Green Investment: 2023 Green Finance Strategy, HM Government, 2023, https://assets.publishing.service.gov.uk/media/643583fb877741001368d815/mobilising-green-investment-2023-green-finance-strategy.pdf

SECTOR	WHAT POTENTIAL ASSETS ARE THERE AND WHY ARE THEY IMPORTANT?	INVESTMENT NEEDED (PER YEAR BY 2035)[23]	POTENTIAL SAVINGS (PER YEAR BY 2035)[24]
POWER – FUEL SUPPLY AND ELECTRICITY GENERATION	**Electrification – with emphasis on renewables:** Fossil fuels will need to be phased out with a significant increase in variable renewables. Wind is expected to be the backbone of the UK system, supported by solar. New system must have improved flexibility in terms of storage and demand.	£15 billion, reducing to £5 billion in 2050	Estimates that changes would lead to operational cost savings of £10 billion by 2050 compared to the high carbon baseline
	Nuclear: Nuclear energy has a key role in achieving net zero objectives as it is a crucial source of reliable low carbon energy. It is often overlooked by pension funds on grounds of investment priorities and moral questions around use of nuclear energy. The Government is looking to unlock private investment and the potential for investable assets should be seriously considered.		
	Low-carbon energy generation – biomass and hydrogen: Estimates suggest that there will need to be a transition from producing 1,100 TWh of fossil fuels and 170 TWh of bioenergy in 2018 to producing 425 TWh of low-carbon hydrogen and bioenergy in 2050. To achieve a 75% reduction in fossil fuel supply will require significant development in biomass energy generation with improved carbon capture and storage and the development of low-carbon hydrogen fuel supply.	£4.6 billion by 2030 rising to £7 billion in 2050.	Accounted for in abatement costs in relevant sectors
GREENHOUSE GAS REMOVALS	As well as significantly reducing our output of greenhouse gases, the UK will need to invest in technology to remove them from the atmosphere. This includes capture of CO2 from sustainable biomass power generation and direct air capture of CO2 with storage.	£2.3 billion	Hard to quantify dependent on which sector investment occurs in
TRANSPORT	**Aviation:** The aviation industry requires behavioural changes, but also needs significant developments in sustainable aviation fuels, as well as developments to aircraft technology. In addition, to achieve net zero by 2050, the aviation industry will need to invest in greenhouse gas removal technologies.	£390 million	Could yield savings of £1.2 billion
	Shipping: Ships will primarily need to be more efficient and electrified. Greatest emission savings are expected to come from development of zero-carbon fuels.	£160 million	Zero-carbon fuel tech could yield savings of £850 million
	Surface transport: Research highlights that a large reduction in car travel will be required[25]. A high take up of electric vehicles alongside significant developments in EV re-charging infrastructure is required to achieve this. Improved solutions for high-emitting Heavy Goods Vehicles will also be necessary. Major developments can be made through investment in better public transport, particularly across a greater range of UK cities. Though investment in improved transport links requires significant developments in supporting infrastructure (train stations etc.) which, to date, has not been fully considered.	£12 billion	EVs alone could save £20 billion

23. Sixth Carbon Budget, Climate Change Committee, 2020, https://www.theccc.org.uk/publication/sixth-carbon-budget/
24. Ibid
25 Ibid

SECTOR	WHAT POTENTIAL ASSETS ARE THERE AND WHY ARE THEY IMPORTANT?	INVESTMENT NEEDED (PER YEAR BY 2035)	POTENTIAL SAVINGS (PER YEAR BY 2035)
WASTE PREVENTION	There is a lot of behavioural change required to reduce food waste and improve recycling. However, there is significant need for infrastructure development in the form of improved carbon capture and storage at energy from waste plants (EfW) and in relation to landfill methane capture. In addition, improvements will be needed to wastewater treatment processes.	£175 million throughout 2020s - £1.3 billion per year in 2030s to account for retrofitting of carbon capture technologies at EfW plants.	N/A
HEAT AND BUILDINGS	The CCC identifies four priorities[26] that need to be tackled in our buildings in order to achieve climate targets: • Upgrading all buildings to EPC C in the next 10-15 years. • Scaling up the market for heat pumps as a means of contributing to the improved energy efficiency of buildings. • Expanding the rollout of low-carbon heat networks in dense, city areas. • Preparing for the potential role of hydrogen. The CCC have identified buildings as one of the costliest challenges across the economy.	£12 billion per year to 2050. £360 billion in investment needed. £250 billion for homes, £110 billion for commercial buildings.	Costs offset by reductions in operating costs of around £5 billion per year.
INDUSTRY	**Agriculture and land use:** • Investment needed to implement measures to cut emissions from soils, livestock, waste and manure management. • Fossil fuel usage is high in agricultural vehicles, buildings, and machinery. Efforts to decarbonise are needed as with changes needed to transport. • The CCC propose five measures that would release land to improve agricultural productivity. Some behavioural, but changes like improving productivity and moving horticulture indoors will require investment.	£1.5 billion - £1.4 billion in the land sector and £0.1 billion for agricultural measures.	Social benefits of land-based measures could contribute £0.1 billion to the economy in 2035, rising to £0.6 billion in 2050.
	Manufacturing and construction: Improvements can be made in the form of efficiencies in the way energy and resources are used and through substitution of materials like cinker in cements and greater use of wood in construction.	£2 billion	Costs partially offset by saving £1 billion through energy efficiency.
NATURE	UK has a legally binding target of halting the decline in domestic species abundance in England by 2030, and then increasing abundance by 10% by 2042. This, according to 2023 Green Finance Strategy, can meet targets and establish the UK as a leader of private investment in natural capital.	£500m – rising to £1 billion by 2030.	N/A

26. Sixth Carbon Budget, Climate Change Committee, 2020, https://www.theccc.org.uk/publication/sixth-carbon-budget/

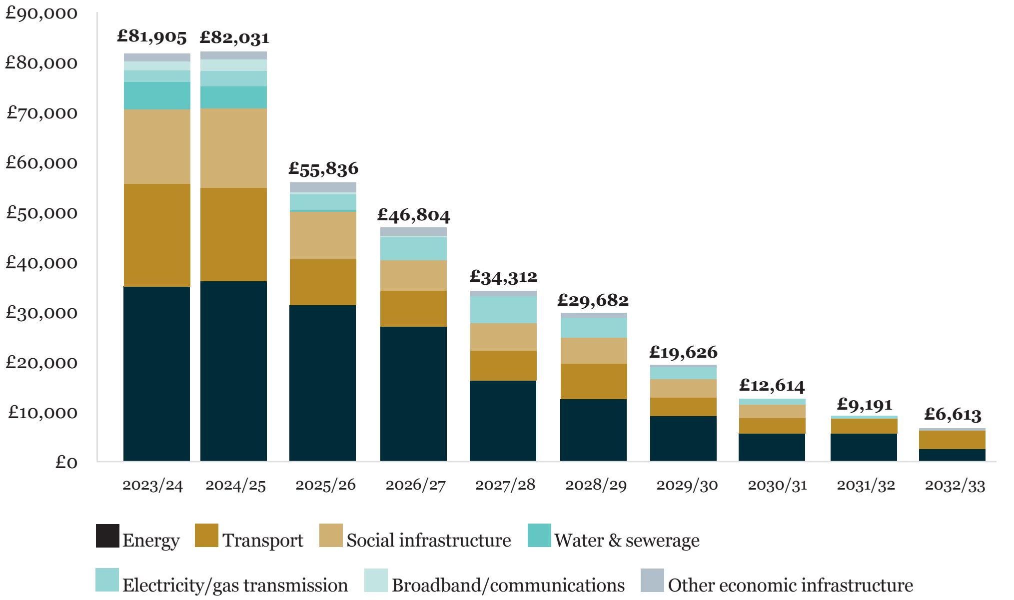
INFRASTRUCTURE:

Infrastructure can be interpreted in a wide variety of ways; the Infrastructure and Projects Authority (IPA) consider infrastructure needs in two broad categories within the Analysis of the National Infrastructure and Construction Pipeline 2023[27]:

ECONOMIC INFRASTRUCTURE	SOCIAL INFRASTRUCTURE
• Broadband / communications • Electricity & gas transmission • Energy • Flood / coastal defence • Science & research • Transport • Water & sewerage	• Borders & policing • Defence • Education • Health & social care • Housing & regeneration • Justice • Tax & customs • Work & pensions

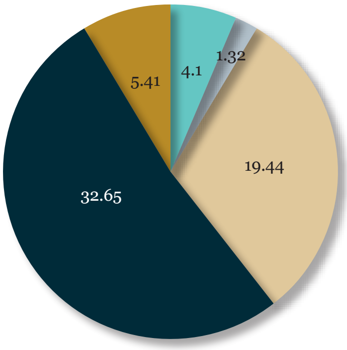
Analysis of the National Infrastructure and Construction Pipeline[28] identifies that there is already between £700-775 billion worth of projected / planned infrastructure spend anticipated up until 2032/33. The chart below provides a breakdown of this. The report also highlights significant scope for further private investment in infrastructure in this period.

PROFILE OF PLANNED PIPELINE INVESTMENT BY SECTOR (£) 2023/33



27. Analysis of the National Infrastructure and Construction Pipeline 2023, Infrastructure and Projects Authority, 2024, https://assets.publishing.service.gov.uk/media/65bb86d7cc6fd600145dbe3e/Analysis_of_the_National_Infrastructure_and_Construction_Pipeline_2023.pdf
28. Ibid

PRIVATE INVESTMENT NEEDS (£ BILLION)



It is important to consider potential investable assets across climate and infrastructure together because there is significant crossover. Many of the potential assets within infrastructure are specifically green ones (renewables, electrification of the economy, transport) and pension funds would expect that all new infrastructure projects will be considered through the lens of the UK's net zero commitments.

SECTOR	SUMMARY OF THE NEED	PRIVATE INVESTMENT NEED
SOCIAL INFRASTRUCTURE	Social infrastructure projects are almost entirely publicly funded. However, more needs to be devoted to social infrastructure to improve quality of life and unlock the economic benefits that could bring. To effectively leverage private capital to do so, much more clarity will be needed on how blended finance models could work.	£19.44 billion
TRANSPORT	Whilst there has been significant transport funding with the rollout of Network North and further announcements on Northern Powerhouse Rail and road resurfacing, significant additional investment is needed to support planned infrastructure and to develop new technologies to meet the UK's net zero goals.	£5.41 billion
ENERGY	The energy sector has a crucial role to play in the transition to net zero. According to the IPA, £82 billion of investment is already planned.	£32.65 billion
BROADBAND COMMUNICATIONS	A recently published productivity report has identified that in the last year, the UK economy has suffered a loss of £17.6 billion in economic output due to connectivity outages[29]. In London alone, this was £5.7 billion – representing over 1% of London's total GDP. The previous Government invested in connectivity and bringing the latest broadband technology to homes and business in the UK. But clearly there is a lot more to be done and potential assets for investment that will deliver returns for investors in more ways than one.	£4.1 billion

29. Productivity report: Broadband outages costing UK economy £17.6bn – but compensation is nowhere to be seen, Vorboss, 2024, https://primaryinvestmentnews.com/2024/04/24/broadband-outages-costing-uk-economy-17-6bn-but-compensation-is-nowhere-to-be-seen/#:~:text=Key%20findings%20of%20a%20productivity%20report%20launched%20today,billion%2C%20representing%20just%20over%201%25%20of%20London%E2%80%99s%20GDP.

Pension funds already invest in infrastructure assets delivering positive impacts on the environment as the following case studies show.

CASE STUDY

Railpen 94% stake in battery storage platform[30]

This report highlights how a vital part of the climate transition involves a greater electrification of the UK economy. As one example, in 2022, Railpen took a 94% joint stake in Constantine Energy Storage, a grid-scale battery energy storage platform company. We know that battery storage is a key technology to enable greater reliance on renewable energy generation and to ease pressure on the Grid, and the firm plans to invest over £400m to build out a pipeline of battery energy storage projects in key locations around the UK. While clearly additive to the UK's transition to net zero, this long-term direct investment should also provide strong investment growth and income to support scheme members' retirements.

CASE STUDY

Gravity Loan - Merseyside Pension Fund (MPF)

As part of its approach to diversifying away from public market holdings and into alternative assets, Merseyside Pension Fund, through the Gravity Loan scheme, has provided financing to facilitate the remediation and development of a more than 600 acre site in Somerset which has been recently selected by the Tata Group for the location of its £4 billion electric car battery gigafactory.

The site gained Enterprise Zone status in 2017, valid until 2042, meaning that businesses basing themselves on the site benefit from lower taxes, access to superfast broadband, and streamlined planning permission to facilitate local infrastructure.

In 2022, the Gravity Local Development Order (LDO) was adopted by Sedgemoor District Council (now Somerset Council). The LDO is a streamlined form of planning consent, contributing to the UK proposition to attract investors and new business to Somerset, as it provides certainty to inform decision-making. The site had outlined planning consent for up to 1.1 million square metres of industrial space and 750 homes under the LDO.

In addition, Gravity is collaborating with Bridgwater & Taunton College to create a leading network of education and skills initiatives. Together, they developed a "Skills Charter" intended to outline principles and objectives from which individual Employment

30. AIMCO AND RAILPEN ACQUIRE A 94% STAKE IN CES, Railpen, 2022, https://www.railpen.com/news/2022/aimco-and-railpen-acquire-a-94-stake-in-constantine-energy-storage/

and Skills Plans for each occupier/site will be developed to deliver benefits to the local community, Gravity, and its occupiers. The objectives are to meet occupier demand for talent and provide strategic linkages into local schools, such as Bridgewater and Taunton College, to foster young people's ambition and provide the new workforce with support and training.

The Gravity site offers bespoke renewable and low-carbon on-site energy solutions and has licences to abstract up to 1.1 million cubic metres per year from the adjacent Huntspill River. In 2019, Gravity was shortlisted by the Advanced Propulsion Centre commissioned by the previous Government to identify locations for gigafactory sites. Gravity also has strategic ties with the Faraday Institute to attract battery producers to the UK, leading to discussions with global battery producers about potential factory requirements.

The efforts of promoting the site led to the Tata Group announcing that it had chosen Gravity for the location of its £4 billion electric car battery gigafactory. It will be one of the largest-ever investments in the UK automotive sector and is said to create up to 4,000 highly skilled jobs on-site. With an initial output of 40GWh, it will be one of the largest factories in Europe, providing almost half of the battery production that the Faraday Institution estimates the UK will need by 2030 to support its transition to zero emissions vehicles.

The gigafactory will secure UK-produced batteries for another Tata Sons investment, Jaguar Land Rover (JLR), as well as other manufacturers in the UK and Europe. It will supply JLR's future battery-electric models, including the Range Rover Defender, Discovery, and Jaguar brands. Production at the new gigafactory is due to start in 2026.

HOW TO MAKE POTENTIAL ASSETS INVESTABLE FOR PENSION FUNDS

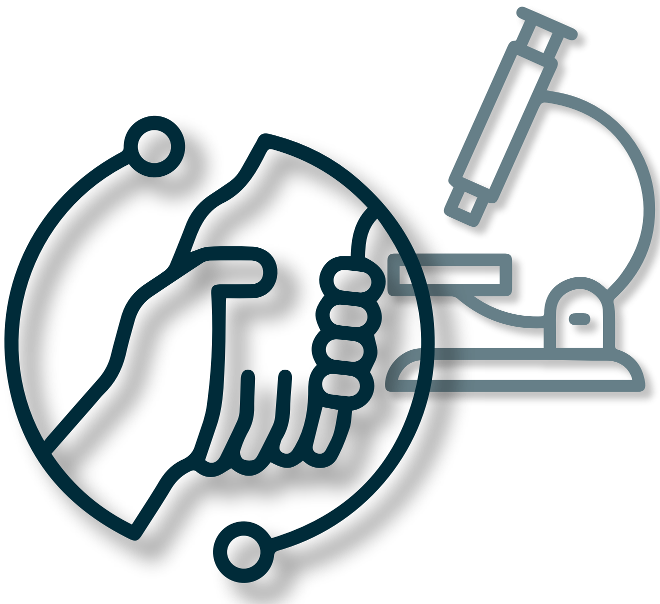
In the table below, we have highlighted just some of the potential assets that exist in this area. The investment need across the category of green, or climate-friendly infrastructure is vast, and so, primarily, more direction will be needed from the Government to indicate where investment should be directed and to make those assets as attractive as possible for pension funds.

Broadly, an industrial strategy needs to be developed, prioritising net zero within all infrastructure projects, and clarifying the approach to both levelling up (especially for transport infrastructure) and planning reform. This way, the Government will instil the necessary confidence for industry to commit long term funding to such projects and initiatives, where they meet the investment needs of savers.

In addition, the Government should give consideration to how fiscal incentives can be tailored to specific sectors and regions to attract a range of investors with different objectives. Identified below are examples of the actions required to make assets more investable for pension funds in targeted sectors.

<table>
<tr><th>SECTORS FOR INVESTMENT</th><th>PENSION FUND CONSIDERATIONS</th><th>HOW CAN WE MAKE THESE ASSETS MORE INVESTABLE?</th></tr>
<tr><td>NUCLEAR ENERGY</td><td>Nuclear energy may offer a significant source of future energy, so long-term investment in these projects could offer returns. However, such projects typically take long periods of planning and build, and uncertainty over potential large cost overruns, meaning return track records can be poor.
Nuclear energy is controversial, and investments can lead to significant member complaints, so inclusion in default funds might pose risks.</td><td>More smaller scale regional nuclear projects may offer better returns with more certain timelines, as well as regional benefits.</td></tr>
<tr><td>RENEWABLE ENERGY GENERATION – AND INVESTMENT IN THE SUPPORTING INFRASTRUCTURE (BATTERY STORAGE / INVESTMENT IN THE GRID ETC.)</td><td>Onshore and offshore wind can provide good investments for DC (initial investment, planning and development phase), and DB/LGPS (energy generation phase) schemes.
This is dependent on the strike price in contracts – if set too low, the returns become unattractive, especially when compared to bond yields.
Planning regulations can slow and stifle these developments, while the cost – especially with inflation – can prevent projects getting off the ground.
Solar - UK has a target to reach 70GW of solar capacity by 2035 from 14GW in 2021. These projects are more straightforward to build than wind farms, however seasonal nature means they do not help with baseload capacity. Further investment in battery storage and grid connections needed.
Grid – investment in the grid to improve transmission and capacity is needed to enable more projects to come online. Current backlogs for connection into 2030s delay projects and stifle returns for investors.
Unclear the degree to which investors can invest in the grid and whether it is a potential asset in itself. Investors seeking clarity on whether the mechanism is to invest in the utilities companies who then launch specific projects.
Battery storage holds the key to the success of other renewable energy sources in terms of smoothing and flexibility of power generation and supply. The Grid expects storage requirements for 2030 to reach 30GW with 20GW to be provided by battery storage.</td><td>Planning reform could help streamline the process for approving/building these projects.
Government and the regulator need to reconsider the contract for difference process; without this, pricing remains uneconomic.
Rules around grid connection could be changed to prioritise more developed projects.
Measures such as a cap and floor mechanisms could be considered, for example. Investors want to see their capital investment de-risked in the first 10 years with a return on the capital invested over the remaining useful life of the asset. The longer the revenue certainty given to the investor the lower the cost of capital tends to be.
Better location signalling from electricity operators over where new battery sites should be built would aid investor confidence.</td></tr>
</table>

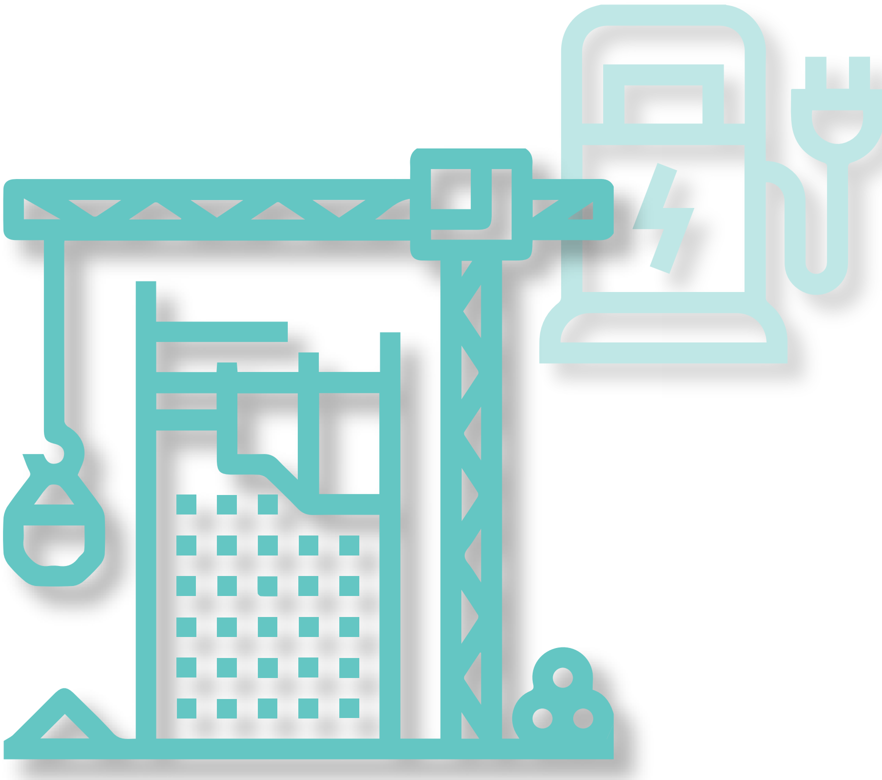
SECTORS FOR INVESTMENT	PENSION FUND CONSIDERATIONS	HOW CAN WE MAKE THESE ASSETS MORE INVESTABLE
HEAT AND BUILDINGS	• Upgrading/improving the energy efficiency of existing UK building stock is a significant challenge. Facilitative technologies such as smart meters are a step on this journey, and one example of a business receiving increasing investment. Such young companies will often be privately owned, and in this growth phase they could be a good, potential asset for DC investors over the long term, if structured appealingly.	• Existing incentives for homeowners to upgrade systems remain unattractive, and payback depends on long tenure. Changes to policy here could increase uptake. • Blended investment into skills is needed to reduce delays in heat pump installation.
CARBON OFFSETS	• As companies seek to reduce carbon footprints, carbon offsetting will be increasingly important, especially where emissions cannot be further reduced in certain activities. • Alternative assets such as forestry, while an investment in its own right, can also provide schemes with growth by selling carbon offset credits to corporates. These can be sold at present value or as future contracts, and offer high potential investment growth, primarily for DC savers with long investment horizons.	• Manager fees can be high for these assets, while returns face risks from volatile future carbon prices and physical risks to forestry assets themselves. Fees need to be reduced.



SOCIAL AND COMMUNITY GROWTH FUNDS

Considering social factors within investment decisions is growing in importance for pension funds. The PLSA has published best practice case studies[31] to support trustees in their decision-making in this area and the Government-initiated Taskforce on Social Factors culminated in valuable industry guidance[32].

Consideration of social factors has close connection with investment in local communities, and the previous Government was supportive of this, as made clear in the Spring Budget where there was an increased emphasis on community-based investment though the proposed Investment Zones programme. As the table below shows, there is a significant investment need across this theme.



31. Putting the spotlight on social factors: Best practice case studies, PLSA, 2024, https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2024/Putting-the-spotlight-on-social-factors-best-practise-case-studies-Feb-2024.pdf
32. Considering Social Factors in Pension Scheme Investments: a guide from the Taskforce on Social Factors, Independent report from the Taskforce on Social factors, 2024, https://www.gov.uk/government/publications/considering-social-factors-in-pension-scheme-investments-a-guide-from-the-taskforce-on-social-factors

SECTOR	SUMMARY OF NEED	INVESTMENT REQUIRED (PER YEAR)
SOCIAL HOUSING	Research shows for enough private capital to embark on a social housebuilding programme to meet UK demand, the Government will need to invest on average £14.6 billion each year between 2021-2031 to leverage enough private capital for a housebuilding programme worth a total of £46.2 billion per year[33]. To retrofit the existing social housing stock to meet the Government's target of achieving EPC C standard (and contribute towards the UK's net zero goal), a total investment of £104 billion is needed[34].	£46.2 billion (split as £14.6 billion of Gov investment/ £31.6 billion private investment)
TRANSPORT	In scrapping elements of HS2, the previous Government indicated that there will be an increased focus on using improved transport networks in specific regions of the country to unlock local priorities. £36 billion was announced for Network North, but there was a strong view that this alone will not be enough. Many have concerns over the lack of consideration given to the investment needs of supporting infrastructure – in the case of Network North, the need for investment in train stations to deal with the improved train lines. But as we have touched on elsewhere in the report, investment will be needed across the country to transition away from car use towards environmentally friendly public transport.	Unclear
SOCIAL CARE	In 2022/23, total net public expenditure on social care was around £24.5 billion. This encompasses net local authority expenditure of £20.5 billion[35] and the previous Government's planned spending on social care services by the NHS of £4 billion. This is a vast amount of money, but it is striking that in 2021/22, of the 1.98 million adults who applied for social care support, only 818,000 received some form of long-term care (around 43%)[36]. Whilst estimates vary based on methodologies used, the social care funding gap is huge. With increasing demand for social care and an increasing cost of delivering social care, it is expected that between £7 billion[37] and £18.4 billion[38] of additional spending will be required. Delivery of social care is one issue, but significant investment will also be required to design, fund, scale up and deliver better solutions to complex social care problems. The Government will need to find a way to work with industry to fund this and identify the potential assets for investment.	Between £7-£18.4 billion per year

33. Capital grant required to meet social housing need in England 2021-2031, National Housing Federation, 2019, https://www.housing.org.uk/resources/capital-grant-required-to-meet-social-housing-need-in-england-2021-2031/
34. Investing in our future: practical solutions for the UK government to mobilise private investment for economic, environmental and social policy priorities, Sarah Gordon at the Grantham Research Institute on Climate Change and the Environment at LSE, 2023, https://www.lse.ac.uk/granthaminstitute/publication/investing-in-our-future-practical-solutions-for-the-uk-government-to-mobilise-private-investment-for-economic-environmental-and-social-policy-priorities/
35. Local authority revenue expenditure and financing England: 2022 to 2023 - third release, DLUHC, 2024, https://www.gov.uk/government/statistics/local-authority-revenue-expenditure-and-financing-england-2022-to-2023-third-release
36. Key facts and figures about adult social care, The Kings Fund, 2024, https://www.kingsfund.org.uk/insight-and-analysis/data-and-charts/key-facts-figures-adult-social-care
37. Social care: funding and workforce, House of Commons: Health and Social Care Committee, 2020, https://committees.parliament.uk/publications/3120/documents/29193/default/
38. Adult social care funding pressures, The Health Foundation, 2023, https://www.health.org.uk/publications/long-reads/adult-social-care-funding-pressures#:%7E:-text=We%20estimate%20this%20would%20lead,the%20projected%20growth%20in%20demand

INVESTMENT ZONES	In the Spring Budget[39], the previous Government's Investment Zones programme was refocused, giving a £160 million envelope to catalyse local growth and investment in Greater Manchester, Liverpool City Region, Northeast of England, South Yorkshire, West Midlands, and West Yorkshire. The Tees Valley investment zone is looking to focus on the digital and creative sectors and expects to leverage £175 million in private investment over the next 10 years. Government investment could help to unlock a range of potential assets for investment and the expansion of these zones to other regions could unlock even more private investment to catalyse local growth.	Unclear – private investment is likely to be led by scale of Government investment.
ARTS AND CULTURE	The UK is still a global leader as a services exporter. This spans a range of services, including culture. The arts and culture industry contributes £10.8 billion per year to the UK economy[40]. Whilst the previous Government announced a package of tax relief measures to catalyse growth in the creative industries[41] at Spring Budget, the arts, culture and creative industries have been in crisis following Covid-19 with total Government funding down 46% in real terms since 2005[42]. The LSE *Investing in our future* report cites the Arts & Culture Impact Fund LLP, a £20 million fund launched by the innovation foundation Nesta. The fund has public, private and philanthropic investors which provide affordable loans to culture and heritage organisations. Scaling up the availability and affordability of finance for arts organisations with social aims can drastically improve the growth of the arts sector whilst supporting local communities.	Industry faces challenges. Reduced attendance/ cost of living/attitudes following covid[43]. Sector reliant on Government funding typically, does this model need re-thinking and how?
WIDER SOCIAL FUNDS	Could comprise additional investment in[44]: private credit offerings to make more lending capital available for social enterprises, private credit more widely for sustainable infrastructure, energy, industry and food security and inclusive finance offerings.	Unclear

Our members are working to consider social factors and the place-based impact of their investments. We think it is vital to bring attention to these to show that there is not a need to mandate investment into these types of assets. The case studies also highlight that investment models and approaches exist which provide a blueprint for what can be achieved and show that these investments can deliver effective returns for pension schemes, consider the social impact and help deliver UK growth.

39. Spring Budget 2024, HM Government, 2024, https://www.gov.uk/government/publications/spring-budget-2024/spring-budget-2024-html
40. Contribution of the arts and culture industry to the UK economy, Arts Council England, 2019, https://www.artscouncil.org.uk/research-and-data/contribution-arts-and-culture-industry-uk-economy
41. Spring Budget 2024, HM Government, 2024, https://www.gov.uk/government/publications/spring-budget-2024/spring-budget-2024-html
42. The road to recovery: Musicians and Covid, 2022, Musicians Union, https://musiciansunion.org.uk/news/the-road-to-recovery-musicians-and-covid
43. New research reveals extent of the challenges facing the cultural sector, The Audience Agency, 2023, https://www.theaudienceagency.org/news/research-reveals-extent-of-challenges-the-arts-and-culture-sector-is-facing-#:~:text=Yes%2C%20the%20Chancellor%E2%80%99s%20most%20recent%20budget%20included%20tax,that%20the%20status%20quo%20simply%20isn%E2%80%99t%20sustainable%20anymore.
44. Investing in our future: practical solutions for the UK government to mobilise private investment for economic, environmental and social policy priorities, Sarah Gordon at the Grantham Research Institute on Climate Change and the Environment at LSE, 2023, https://www.lse.ac.uk/granthaminstitute/publication/investing-in-our-future-practical-solutions-for-the-uk-government-to-mobilise-private-investment-for-economic-environmental-and-social-policy-priorities/

CASE STUDY

Railpen investment in mental health facility[45]

In late 2022 Railpen began the funding of the redevelopment and extension of an existing mental health facility in Sunderland for the Cumbria, Northumberland, Tyne and Wear NHS Foundation Trust. The initiative will modernise and expand the existing facility enabling better support to be provided to patients, staff and the local community.

Railpen made this investment on a direct basis, conducting due diligence and legals in-house, therefore reducing cost for members, and over a period of 30+ years, the investment will provide the inflation-linked income required by the DB scheme to match liabilities.

CASE STUDY

Church of England Pension scheme – Utilising debt finance (like housing associations)

There is a chronic shortage of social housing and the Government has been clear in its commitment to house building with a focus on prioritising the building of social rented homes.

Pension fund support to provide the investment for this commitment could be effectively harnessed. As the Church of England pension scheme demonstrates, there is an established UK model for harnessing the power of long-term institutional investors such as pension funds to support 'common good' investment. Using social housing as an example, housing associations (HAs) or registered social providers are typically not-for-profit entities meaning they are neither public sector, nor are they profit making in the private sector.

HAs raise finance for investment in new social housing through the issuance of bonds including public quoted bonds. The characteristics of these bonds are ideal for pension funds. They are long term, typically yield more than gilts, have a low default risk and are generally inflation linked. They are useful diversifiers within the liquid bond market as they are not dependent on the fortunes of private companies. As a pension fund, the Church of England pension scheme holds a number of social housing bonds within their buy and maintain bond portfolio and, with their charitable arm, they provide retirement housing following the same model.

Additionally, the charitable arm of the Church of England (which is financially separate from the Church of England pension fund) provide retirement housing and, in doing so, issue listed bonds themselves. One is CPI linked and one is fixed rate, both are typically purchased by players in the pensions/bulk annuity space. This is interesting for UK growth because not only is the investment in the common good, but it is a way to grow the economy and meet key needs without requiring direct Government investment which may not always be a viable source of finance.

45. RAILPEN TO FUND DEVELOPMENT OF NEW MENTAL HEALTH FACILITY IN SUNDERLAND, Railpen, 2022, https://www.railpen.com/news/2022/railpen-to-fund-development-of-new-mental-health-facility-in-sunderland/

CASE STUDY

Clwyd Pension Fund's approach to their impact and place-based portfolio

Clwyd Pension Fund provides an example of the range of potential assets available for investment that not only support local communities but also deliver effective returns for members.

Clwyd Pension Fund's allocation to private market assets stands at 29% and this has steadily increased over time. 6% of the Fund's overall allocation is in impact/local assets and this is a result of deciding to strategically identify local opportunities from 2016 onwards. It is worth noting that as of March 2023, 19.7% of the Fund's place-based portfolio has been invested in Wales.

The investments vary and Clwyd have invested with a range of other parties including the Development Bank of Wales alongside the Welsh Local Government Association (WLGA), the Greater Manchester Pension Fund and South Yorkshire Pension Fund as well as with their wider pool where opportunities have been identified which are too large for them on their own.

Clwyd's place-based investment approach has supported England and Wales in the following ways:

- 86 SME businesses have been supported through equity or debt finance since 2013, 20 of which are in Wales.
- Over 13,400 employed and at least 1,800 jobs created in these businesses during the period of Clwyd's investment.
- 12 businesses are Living Wage Foundation businesses or pay all employees the real Living Wage.
- 3,369 new homes in area where lower cost homes are needed, 27% of homes are affordable.
- 11 assisted and senior living homes for up to 490 residents.
- 34 educational facilities acquired, 2,700 additional child spaces created (85% nursery spaces, 10% SEN, 5% independent school places).
- 740 permanent real Living Wage jobs supported in leisure-based real estate, 25% in Wales.
- 43 commercial real estate developments creating employment space for over 12,000 people (25% in the most deprived local authorities nationally).
- £50 million committed to the development of clean energy in Wales to begin being deployed in 2023.

US Social Housing Tax Incentives: The Low-Income Housing Tax Credit (Housing Credit) and the New Markets Tax Credit (NMTC)

As well as building on established models for investment in housing that already exist in the UK, there is also much that can be learned from international best practice which the Government should consider to support pension funds to support its aims for growth.

The US has a federal tax incentive called the Low-Income Housing Tax Credit programme (Housing Credit)[46]. The programme is responsible for nearly all the affordable rental housing built and preserved in the United States since the programme's authorisation in 1986. It has financed 3.85 million affordable homes to nearly nine million low-income families, seniors, veterans, and people with disabilities.

How it works

- The Housing Credit programme allows a dollar-for-dollar reduction in a taxpayer's income tax liability for making a long-term investment in affordable housing.
- It is a federal tax incentive that is run by states, who are responsible for awarding their federal allocation of Housing Credits to developers that meet the state's housing needs and priorities.
- Most developers then choose to find tax credit investors, who provide cash that is put into the development.
- Investors provide upfront equity capital to fund the construction or rehabilitation of affordable housing, allowing developers to borrow less money and charge lower rents for low-income tenants. They receive a 10-year stream of tax credits based on the cost of constructing or rehabilitating the apartments rented to low-income households.
- Investors can either invest directly in the project or work with a syndicator who acts as a broker between the developer and investor. To benefit from economies of scale, syndicators will pool several projects into one Housing Credit equity fund, spreading the risk across various projects.
- The Housing Credit is a 'pay-for-success' model where federal tax credits are awarded only after properties are successfully completed and occupied.
- Housing Bonds (tax-exempt private activity bonds used by state housing agencies to acquire, construct, and rehabilitate affordable rental homes) are increasingly used to support the financing of Housing Credit properties.

Given the success of the Housing Credit, there have been other, similarly structured tax incentives in the US, including one called the New Markets Tax Credit (NMTC). In addition to affordable housing, NMTC projects include the construction of community facilities, health care centres, industrial spaces and more. The programme delivers capital to underserved 'new markets', acting as a gap-financing tool to revitalise communities.

46. Low Income Tax Credit program (Housing Credit) advocacy toolkit, The Action Campaign, 2024, https://rentalhousingaction.org/advocacy-toolkit/

POTENTIAL ASSETS FOR PENSION FUNDS

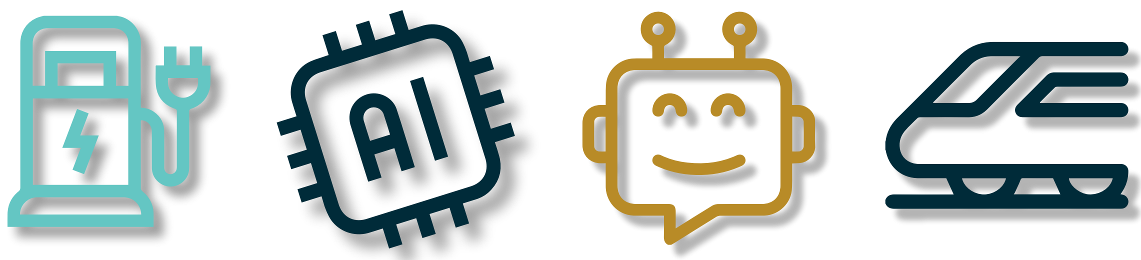
The case studies above demonstrate the breadth of potential assets available for place-based/impact investment, but more needs to be done. With the previous Government focused on the importance of the levelling up agenda, investment with consideration to social factors and the needs of UK communities continues to be a high priority and one that can deliver UK growth. To build on promising local growth initiatives like the previous Government's Investment Zones programme, more clarity will be needed on:

- Whether there are plans to continue, or even expand such programmes, the industry will be seeking clarity on what role blended finance might play. It is vital that there is collaboration between the Government, business, asset managers and end investors.
- What tax incentives could be offered to businesses.
- What interventions might be planned to support improvements in skills, research, innovation, and infrastructure.

Additionally, the case studies provide some tangible examples of how this type of investment can work in practice.

- The MPF example outlines a successful model for investing in assets at scale.
- The Clwyd Pension Fund case study demonstrates how local businesses can be supported while providing returns to pension savers.
- The debt financing model for social housing set out in the Church of England pension scheme case study demonstrates a way to invest in the common good away from the Government balance sheet at a time when direct Government investment is not viable. It is an established financing model in social housing and one that could be applied to other common good entities. For example, long-term bonds from NHS trusts to underpin hospital investments or investments in other infrastructure projects (like energy/transport) if a public body were to take over. The approach has all the characteristics that pension schemes like in terms of long-term, stable and index-linked revenues without illiquid tie up.

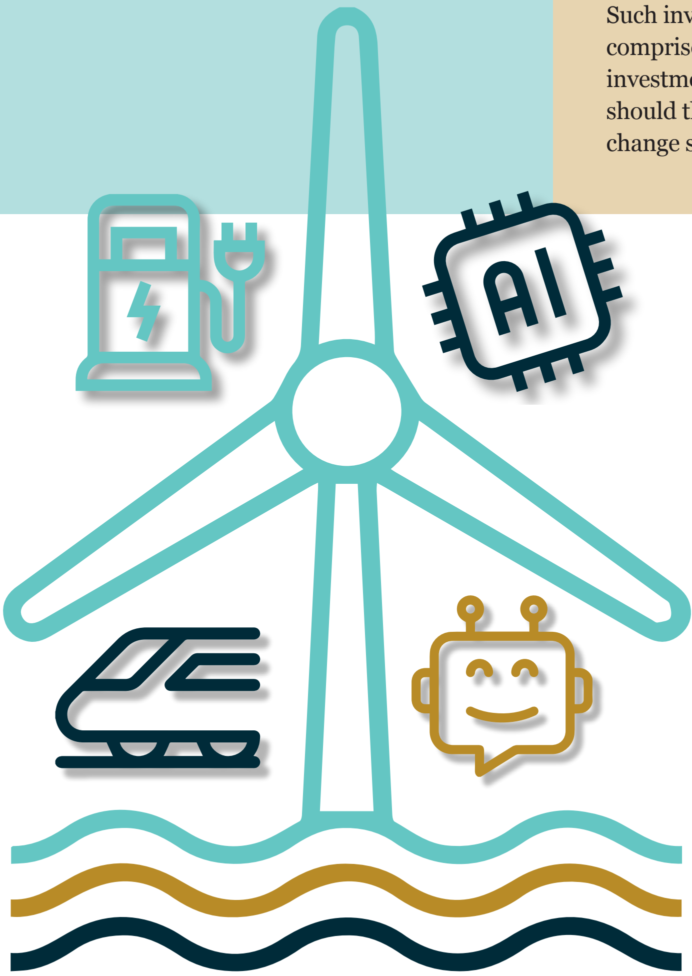
Identified below are examples of potential assets and actions that can be taken to make them more attractive for pension fund investment.



<table>
<tr><th>POTENTIAL ASSETS FOR INVESTMENT</th><th>PENSION FUND CONSIDERATIONS</th><th>HOW CAN WE MAKE THESE ASSETS MORE INVESTABLE?</th></tr>
<tr><td>LATER LIFE HOUSING AND SOCIAL CARE</td><td>With a rapidly ageing population there are increasing strains on housing and social care support for the elderly. Less than 1% of British people over the age of 60 currently live in senior housing, compared to 17% in the US and 13% in Australia.
Potential assets could include senior living provisions, e.g. 'retirement villages', as well as care homes.
Overall, lack of clarity and certainty over policy direction in these areas stifle investment.
Additionally, whilst the delivery of social care is one significant issue, a major increase in investment will also be required to design, fund, scale up and deliver better preventative solutions that enable people to effectively manage their own care as they age.</td><td>Planning processes around regeneration projects could better incentivise developments that cater for senior housing requirements.
Clarity over state/private financing of adult social care is imperative. This clarity of funding, combined with incentives, e.g. to encourage workers in this industry, would make the sector more investable.</td></tr>
<tr><td>SOCIAL HOUSING</td><td>We would expect investment into social housing to be of particular interest to the LGPS. They are well placed to work directly with local authorities to identify local need support in addressing it.
Given the similar attributes of open DB schemes, it is also a potential asset that can work for them. This is emphasised by the Church of England case study.
But there is still a need for DC and DB to do more to consider what value they place on investing with consideration to social factors.
All pension schemes will need to think innovatively about how to make social housing investment work for them. This could be considering working with housing authorities like the Church of England, or working on innovative developments that offer new ways to deliver effective returns – for example, installing solar panels on social housing developments to improve returns.
Covid, and the capex requirements to meet environmental guidelines on the use of office space will increase the obsolescence of non-prime office space. Pension schemes, with the support of Government, should consider whether there is scope for conversion of office to residential property (which could be social housing).</td><td>Planning reform is vital, this includes clarity over the Government's position on office to residential conversion.
Introduction of capital allowances for private investors in social housing.
Learn from the US social housing tax incentives regime (see case study example) which could reduce tax liabilities for private sector investors in social housing and help to unlock investment in housebuilding and retrofitting.
UKSIF recently recommended longer-term rent settlements for social housing providers to support them to retrofit and decarbonise – the introduction of long-term CPI-linked rent ceilings for social housing could facilitate this[47].
Further consideration to the approach of issuing long-term, good coupon, low default risk and inflation-linked bonds to incentivise pension fund investment.</td></tr>
</table>

47. Housing: Financing the Future, UKSIF, 2024, https://uksif.org/wp-content/uploads/2024/03/UKSIF-Financing-the-Future-Housing.pdf

POTENTIAL ASSETS FOR INVESTMENT	PENSION FUND CONSIDERATIONS	HOW CAN WE MAKE THESE ASSETS MORE INVESTABLE?
TRANSPORT	• The current approach to transport infrastructure investment is heavily focused on investment in equities. Whilst this may be viable for DC, DB will be looking for investments that yield more stable returns. • As per our social housing case study, different investments can be structured to suit the needs of investors. So were the Government to issue transport-related bonds, with yields over gilts, these would be of interest to DB schemes, while supporting the development of national infrastructure. These could also be targeted regionally, offering potential assets particularly for LGPS funds.	• Consider the approach of issuing long-term, good coupon, low default risk and inflation-linked bonds to incentivise pension fund investment. • Set out a clear plan and commitment for levelling up and how improving local transport links forms a part of that. • Given the long-term nature of these large-scale infrastructure projects (e.g. HS2), strong cross-party consensus is required to provide the security investors need to commit funding. Such investor security might comprise a guarantee of investment returned at par, should the Government change strategy.



LIFE SCIENCES AND AI

The previous UK Government signalled its intent to transform the UK into "the world's next Silicon Valley" through investment in creative industries, advanced manufacturing, digital technology, AI and life sciences. If the UK is to deliver on its ambition to become a global life sciences superpower by 2030, an estimated £53 billion of sustained investment in research and development is required, with £9.9 billion needed in 2030 alone[48]. This could present a plethora of potential assets for UK investors.

There are many areas, particularly in life sciences, where the potential assets for investment are clear and that have demonstrated significant scope for growth. In other areas, like AI, there appears to be potential for investment, but more clarity from the Government is needed initially to establish the investment need. This category of opportunity is therefore slightly different to the others we have highlighted. Whilst there are some gaps, the issue is more about how the Government can explain to the pensions industry what it sees as focus areas and how it would like to utilise pension fund capital to grow those sectors in a way that also supports the investment aims and objectives of pension schemes.

LIFE SCIENCES

The UK Life Sciences sector is a £94 billion industry which saw £1.8 billion of venture capital investment in 2023[49]. It performs the most research and development of any sector in the UK (totalling £4.8 billion[50] in 2019) and supports almost half a million jobs. The sector is more mature than AI with a clear pipeline of potential assets already available.

A report from PWC and Bristol Myers Squibb, *Re-imagining the Future of Life Sciences 2030*, demonstrated that there are several key areas of focus that require attention if the UK is to truly supercharge the life sciences sector over the next decade:

1. **Data and AI:** The report emphasised that the UK should look at ways to integrate traditional and non-traditional healthcare datasets and lead the way in routinely using AI in diagnostics, clinical decision making and disease prevention.
2. **Clinical research:** The UK should ensure that the NHS leads the way as an innovator of clinical research by allowing UK patients to trial and test innovative treatments from across the globe.
3. **Advanced therapies manufacturing:** The UK can become a global hub for scaling up and manufacturing complex advanced therapies.
4. **Access to innovative medicines:** The UK can improve access to and uptake of innovative treatments and rethink the way that medicines are valued and prioritised.

48. Re-imagining the Future of Life Sciences 2030, PWC and Bristol Myers Squibb, 2021, https://www.pwc.co.uk/industries/assets/life-sciences-2030-report.pdf
49. UK Life Sciences Forecasts 2024, Knight Frank, 2023, https://content.knightfrank.com/research/2798/documents/en/uk-life-sciences-forecasts-2024-2024-10840.pdf
50. Re-imagining the Future of Life Sciences 2030, PWC and Bristol Myers Squibb, 2021, https://www.pwc.co.uk/industries/assets/life-sciences-2030-report.pdf

The chart below illustrates examples of areas for investment to target:

Exploratory research into key health issues like challenging neurodegeneration and dementia.	Addressing the biology of ageing.	Developing a workforce with the necessary skills and knowledge to support a growing industry.
Research to identify ways to improve early diagnosis and treatment of challenging long-term illnesses.	Sustaining the UK's position in vaccine discovery, development and manufacturing.	Tackling obesity.
Exploration into vaccines for cancers.	Treating cardiovascular and respiratory diseases, identifying risk factors and reducing their impact.	Increasing understanding of mental health conditions.

THE VALUE OF INVESTING IN LIFE SCIENCES AND AI

The PWC and Bristol Myers Squibb report highlights that the UK could achieve considerable economic and health benefits from investing in life sciences:

VALUE OF INVESTING IN LIFE SCIENCES

- Between £45-90 billion could be added to the UK economy through greater investment in healthcare.
- £4.4 billion could be added to the UK economy through greater investment in research and development.
- By increasing the number of clinical trial participants, the NHS could receive revenue of £4.4 billion from life sciences companies.
- This could save £2.8 billion in pharmaceutical products.

PROGRESS SO FAR

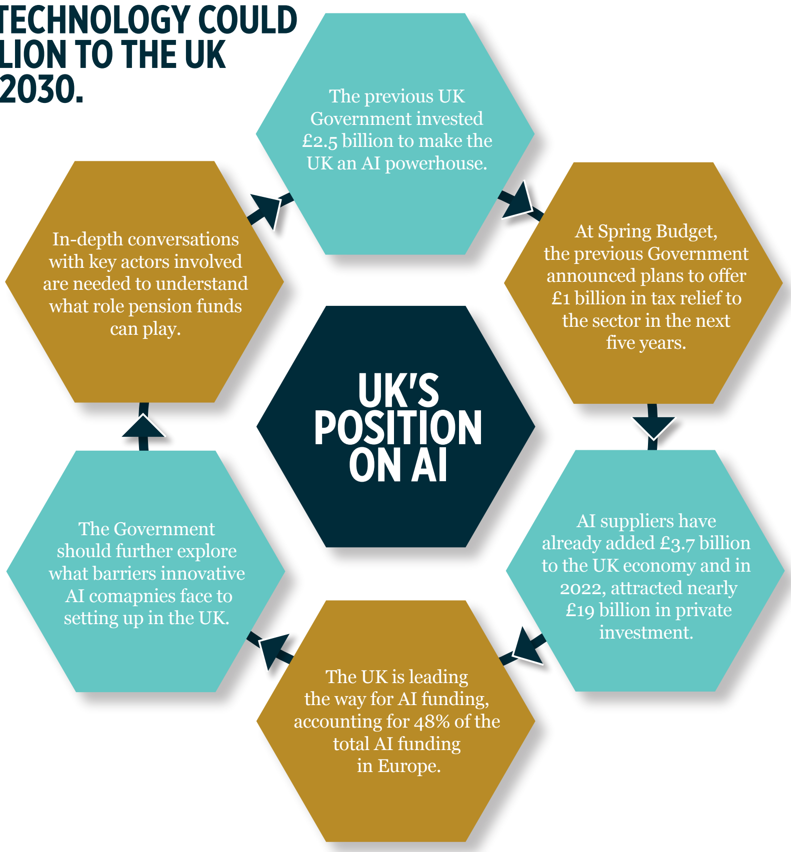
The previous Government made progress, and interventions have been made to improve the availability of capital. In 2023, £17 million of Government funding was announced to unlock a further £260 million of private capital through the Life Sciences Innovative Manufacturing Fund (LSIMF)[51]. It is providing £200 million in funding through the Life Sciences Investment Programme and through the UK-UAE Sovereign Investment Partnership, Mubadala has made an £800m commitment to investment in the UK Life Science sector[52]. This is good progress, but in the context of a £94 billion industry that is estimated to require £53 billion between now and 2030, this level of investment is unlikely to have a significant impact.

51. Life sciences companies supercharged with £277 million in government and private investment, HM Government, 2023, https://www.gov.uk/government/news/life-sciences-companies-supercharged-with-277-million-in-government-and-private-investment
52. Life Sciences Vision - Build Back Better: Our plan for growth, HM Government, 2021, https://assets.publishing.service.gov.uk/media/612763b4e90e0705437230c3/life-sciences-vision-2021.pdf

The life sciences sector demonstrates that there are potential assets for investment in AI in a health context. Whilst this is one application for AI, Goldman Sachs Research estimates that AI investment could approach $200 billion globally by 2025[53]. Evidence suggests there is significant scope for the UK to take a big slice of the benefits. The UK lags only USA and China in terms of investment in AI research and technology and is some way clear of Israel in fourth place[54].

THE UK'S POSITION ON AI

AN ACCELERATION IN AI ADOPTION AND DIGITAL TECHNOLOGY COULD ADD £520 BILLION TO THE UK ECONOMY BY 2030.



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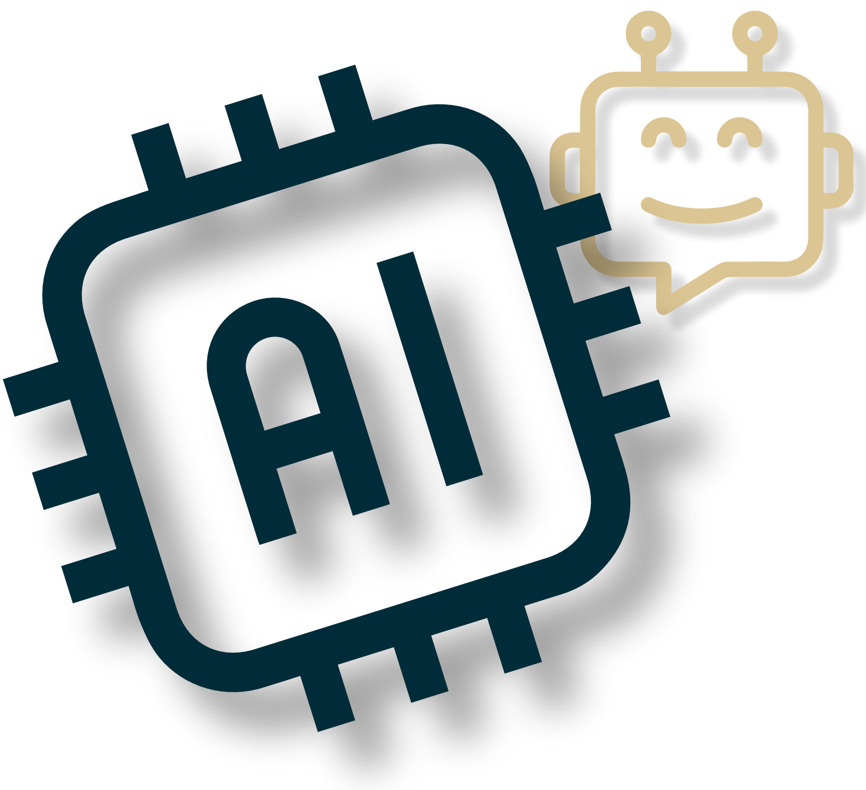
Under the previous two themes, we have listed various specific potential assets, as well as highlighting targeted measures which would make each of them more investable. We have taken a different approach for the life sciences/AI theme. While we consider it to be a key theme, the potential assets and investment methods are less developed. These innovations are at an earlier stage, so we consider it is incumbent on the Government to make clear where, and in what kinds of sectors, they would like to see investment flow. It will then be up to a similar partnership between Government and those relevant industries to realise that investment. Therefore, below, we describe the steps required from each of the key actors.

53. AI investment forecast to approach $200 billion globally by 2025, Goldman Sachs, 2023, https://www.goldmansachs.com/intelligence/pages/ai-investment-forecast-to-approach-200-billion-globally-by-2025.html#:~:text=Incorporating%20that%20information%2C%20along%20with%20our%20equity%20analysts%E2%80%99,the%20U.S.%20and%20%24200%20billion%20globally%20by%202025.
54. Top 10 Countries Leading in AI Research & Technology in 2024, Techopedia, 2024, https://www.techopedia.com/top-10-countries-leading-in-ai-research-technology#:~:text=The%20US%20leads%20the%20way%2C%20with%20almost%2060%25,and%20key%20players%2C%20and%20private%20and%20public%20funding.
55. New research shows that digital technology could add £520 billion to UK economy by 2030, Amazon, 2024, https://www.aboutamazon.co.uk/news/aws/uk-digital-technology-report-2024#:~:text=Thanks%20to%20this%20acceleration%20in,superpower%20as%20early%20as%202028
56. The State of AI in the UK 2023: Trends, Data, Statistics, and Insight, Investing Strategy, 2023, https://investingstrategy.co.uk/financial-news/the-state-of-ai-in-the-uk-2023-trends-data-statistics-and-insight/#:~:text=The%20CBI%20report%20indicates%20that%20digital%20technologies%2C%20including,a%2010.3%25%20UK%20GDP%20as%20reported%20by%20PWC.
57. National AI Strategy, HM Government, 2021, https://assets.publishing.service.gov.uk/media/614db4d1e90e077a2cbdf3c4/National_AI_Strategy_-_PDF_version.pdf

WHAT IS NEEDED TO DRIVE INVESTMENT INTO AI AND LIFE SCIENCES AND MAKE POTENTIAL ASSETS MORE INVESTABLE	
GOVERNMENT	• To attract top AI and life science business to the UK, the Government will need to address the issues facing the UK's capital markets. The UK is lagging comparators in terms of strength of public markets and in terms of IPOs by life sciences companies. • Government must work with pension funds and managers to develop an investment ecosystem that allows access to long-term public and private capital. • Investments in this sector often take the form of private equity or venture capital funds. While the long timescales and growth potential of these do theoretically suit DC investors, to stimulate a cycle of investment, Government will need to incentivise initial investment, either by reducing risk or the cost of investment. There is precedent here, with the LIFTS initiative seeking to do this; other options can include Government taking the 'first loss', similar to structures used in the hedge fund industry, but instead allowing investors to benefit from profit without fees. Such an incentive would materially reduce the downside risk of these investments, while sending a strong signal of the perceived strength of these industries to grow within the UK economy. We will conduct further analysis of these options in our upcoming investment incentives work. • Certain types of pension funds are well suited to offer long-term finance to support these industries but at present the companies to invest in are not readily available. To ensure they are, the Government has a significant role to play in the facilitation of blended finance solutions that support pension funds and managers to commit long-term investment to finance growth.

PENSION SCHEMES	• Given the infancy of AI for investment, trustees and pension funds will need to take steps to understand what investment in this sector looks like. It is likely that they'll look to Government and consultants for advice and guidance.
	• Trustees will need to work closely with their asset managers to consider what the potential assets are and whether they have sufficient assurances that the risks can be mitigated.
	• Pension funds will be seeking assurances that incentives to encourage these companies to the UK do not come at the expense of shareholder rights. Through our engagement with the FCA on their revised UK Listing Rules, we heard that it is often AI/tech companies pushing hardest for lower corporate governance standards as a requirement for listing in the UK.
	• Both the life sciences and AI sectors will require significant long-term capital. We anticipate that most of this is essentially growth/venture capital investments.
	    • This type of investment is likely to be most suited to DC schemes due to the investment horizon. LGPS funds, with their state underpin, and long, open duration, will be well placed to invest, provided with the right structures of investments that match liabilities and inflation. There are likely to be potential assets that have a local/place-based element to them which may appeal more to the LGPS.
	    • We do not expect it to appeal to closed DB schemes given their risk-averse nature to investment.
	    • Open DB schemes are also likely to be open to this type of investment, whilst it will vary scheme by scheme, there is clearly an opportunity for those with surpluses to be willing to take on greater risk and target more growth. It is worth noting however that whilst open to new accrual DB currently makes up around 50% of DB schemes, by 2035 this group may be closer to 20% and so the scale of investment will likely decrease over time.

WHAT IS NEEDED TO DRIVE INVESTMENT INTO AI AND LIFE SCIENCES AND MAKE POTENTIAL ASSETS MORE INVESTABLE	
ASSET MANAGERS	• Asset managers will be seeking assurances that incentives to encourage these companies to the UK do not come at the expense of shareholder rights. We have heard through conversations with the FCA on their proposed listing rules reforms that it is often AI/tech companies pushing hardest for lower corporate governance standards.
CONSULTANTS	• For an emerging industry likely to require significant long-term capital, there will be a growing need for consultancy expertise, including on a sector-by-sector basis, which is currently lacking. • If the Government intends to lead the way in this sector, the support offered by consultants will need to emerge quickly.
INVESTEE COMPANIES	• Inevitably, investee companies in this sector will be seeking to get the best deal they can to list and invest in the UK. • They will be seeking a clear plan for how the Government intends to “create the new Silicon Valley”. In the Spring Budget, the previous Government announced its intention to offer £1 billion in tax relief to this sector over the next five years. Companies will be seeking clarity on how this will crowd in private capital and how they can access it readily.



CONCLUSION

This report demonstrates a clear need for structural investment across four identified themes: climate change, infrastructure, social and community growth funds, and life sciences and AI.

Mobilising pension fund investment into UK productive finance has the potential to result in significant, tangible, real-world benefits for society.

With government, pension funds, investment managers, investee companies and consultants all playing their part, there is huge potential to open the pipeline of assets to utilise the investment capabilities of pension funds to support UK growth.

The Government can play its part by providing policy certainty, for instance through investment guarantees which insulate against political changes in direction, as well as other steps, such as a clear approach to blended finance structures.

There will of course be challenges. The risk appetite of pension schemes will vary according to their maturity and the profile of their memberships. It is essential that investments chosen by pension funds meet the needs of the scheme members and savers who rely on them for their retirement income. Some potential assets will not be accessible through certain investment funds and there may well be capacity constraints and subsequent risk that prices of assets increase with returns potential being compressed.

However, we are clear that the Government, working with pension funds, can lead the way in taking action to set the necessary conditions to encourage pension scheme investment in productive finance in the UK by considering some key interventions:

TRUSTEES AND PENSION FUNDS SHOULD:

- **Develop investment strategies** that consider how to allocate to private market assets appropriately to meet the needs of the scheme and future liabilities.
- **Be aware that training may be required** to ensure there is an appropriate level of knowledge and understanding of social and climate issues and how to integrate these into investment decisions.
- **Encourage advisers and consultants to further consider growth assets in investment strategies** put forward for DB and DC schemes, and consider any gaps in service provider expertise.
- **Understand the risks involved** in different types of investments and how to effectively diversify their portfolio, including clarifying fiduciary duty so trustees are clear that climate considerations are compatible with their fiduciary duty.
- **Ensure Statements of Investment Principles clearly articulate trustee views** on which investment sectors to prioritise.
- **Consider what blended finance structures would make sectors more investable.**

WE CALL ON THE GOVERNMENT TO:

- **Provide policy and regulatory certainty** to improve the UK's appeal versus investment opportunities globally. This includes developing a long-term strategy for investment and growth, outlining the Government's priority investment sectors, its approach to blended finance and how it will work with the pensions industry.
- **Offer targeted fiscal incentives** to make UK growth assets more attractive than competing assets from other countries. Enhancing the tax treatment of domestic investments, as they do in France and Australia, merits further exploration. In addition, initiatives like LIFTS, which supports investment in UK start-ups and companies requiring late-stage growth capital should also be considered.
- **Expand the area of focus beyond private equity and venture capital** to encompass infrastructure, alternative assets and a variety of funding models.
- **Take control in bringing key industry groups together** to develop solutions to growth challenges.
- **Produce a plan for the development of skills** to achieve growth.
- **Lead and collaborate on AI and net zero** at international scale.
- **Continue to work closely with regulators** and others to get the right approach to investment risk, including DC, open DB and the LGPS, where this is in the interest of scheme members.
- **Deliver planning reform** to enable crucial energy, infrastructure, social housing and later life care development.

Overall, with everyone playing their part, there is huge potential to open the pipeline of assets to utilise the investment capabilities of pension funds to support UK growth.

NOTES

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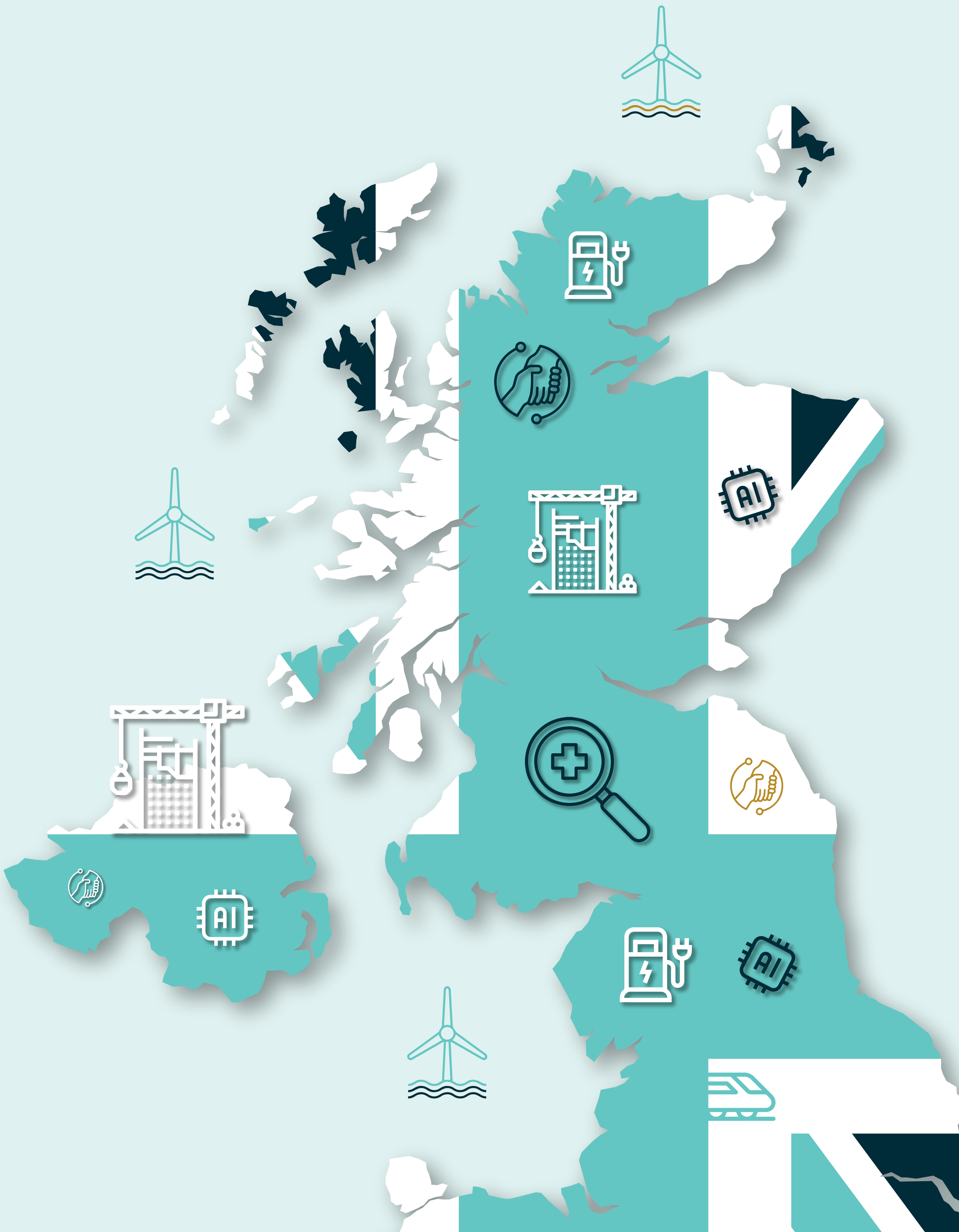

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