



# Pensions, Politics, and Pitfalls: A Closer Look at the Mansion House Accord

Back in May this year, the signatories gathered to congratulate themselves on the Mansion House Accord, following on from the earlier Mansion House Compact of 2023, seeking to 'unlock growth' by directing the investments of millions of pension savers into certain types of assets. But, is this instead about to unlock a sequence of unintended consequences, poorer outcomes and even failure of its basic objective? Quite possibly.

## The original agreement

The original goal of the Mansion House Compact in 2023 was, in essence, to increase demand for unlisted equities and thereby provide capital to 'high growth UK businesses'. In an effort to achieve this, 11 of the UK's major DC pension providers (including most of the big names) committed to allocating at least 5% of their default funds to unlisted equities by 2030 – default funds representing the lion's share of assets within DC schemes.

However, a historical administrative need for often-daily pricing and liquidity, together with the prevailing cap on aggregate DC fees for default funds spelt trouble from the start. And, by February 2024, these signatories had apparently only invested approximately c£800 million (just c0.4% of DC default fund assets) in unlisted equities.

## Restricted outcomes and contentious issues

One of the longstanding problems with DC fee caps is that they were introduced to protect smaller employers and smaller schemes from excessive fees. However, the unintended consequence was that they often precluded better-governed schemes from investing in 'expensive' asset classes, such as those now being considered. Fee rates and structures in private markets and hedge funds meant that these were previously off the menu and, to the extent these could have been additive, the fee cap likely imparted worse outcomes for members (almost certainly on a risk-adjusted basis). Many DC boards, under pressure from regulators and consultants to demonstrate 'value for money', have focused on reducing absolute costs—sometimes at the expense of net outcomes. The focus on net outcomes versus net fees paid has always been a contentious issue (active vs passive management, which benchmarks to use, etc.) and many boards will still have their own views on this. However, to access the assets with the highest expected return (and risk), such as private equity, private debt, and venture capital, higher fees are typically required.



While the Compact excluded property and infrastructure, the new Mansion House Accord expands the scope to include equities, property, infrastructure, private credit, and venture capital.

The goal remains clearly one of 'boosting UK economic growth'.

So pausing there, what would be the best way to achieve that noble goal, to the benefit of all? This becomes a question of time horizon – should the focus be on short-term stimulus or long-term structural reform?

### Short-term vs long-term

Objectively, infrastructure development provides immediate stimulus as well as long-term gains and is the obvious place to start. Structural reforms within a stable economy would likely be next, designed to provide a stable business environment, improvements to productivity and to make the UK attractive to invest in. This means lower taxes, low inflation, reasonable interest rates, incentives for research & development and fostering innovation, paired with longer-term education policies aligned to produce a workforce fit for delivering success. Many of these require investment. Get the basics right, the country attracts capital on merit and there is no need to direct capital.

### A weakening appeal

Sadly, in recent years, excessive government spending, policy uncertainty and resulting historically high tax rates have led to a flight of capital and talent overseas. These trends have intensified over the past year, weakening the UK's investment appeal. Therefore, in terms of a fundamental return to risk assessment, the UK has not been seen as a great place to invest. Furthermore, as is well observed, pension schemes retracting from equity markets and into bonds – in order to match their liabilities and place lower future risk onto companies, in line with specific guidance from regulators, has further reduced the demand for, and price support of, UK equity assets. The reduced demand from large pools of capital has (all else equal) reduced the UK's price (relative to other countries).

This creates a feedback loop: if UK equity markets are undervalued, entrepreneurs are less likely to list domestically, reducing venture capital returns and discouraging future investment, and around the cycle goes.

### An unpopular task

To fix it, the country's fundamentals need to be right and this starts with reining back government spending and making the significant existing debt stock manageable. However, there is no palpable



political appetite for this. If spending keeps rising (and the country's demographics strongly suggest it will), inflation is almost encouraged in order to pay for the (nominal) bill. But this risks higher taxes, weaker Sterling, and rising interest rates—further undermining investor confidence. The vicious cycle could continue until either a more sensible set of policies are adopted, or crisis point is reached - not pretty.

## Where next?

The one seemingly palatable option that has been taken up, via this Accord, is to encourage (with the thinly veiled threat of making mandatory) allocations from one of the nation's last great assets – its pension funds. Relaxing the fee cap to allow for performance-fees. This alone is a welcome step and will naturally attract capital to those investments deemed worthy of it.

However, forcing any investor to allocate to certain assets is risky and could lead to market distortions. This would occur by the inflows pushing up prices of better quality—and more easily packageable—assets, reducing returns for the eventual winner. The risk will also require significant consideration. For example, the venture capital market in Europe, UK in particular, is far behind that of the US in terms of its development. In addition, the larger asset managers, volume-buying mediocre assets at lower fees, will likely collect more of these allocations than those offering access to the genuinely good deals. The number of asset managers offering 'DC friendly' solutions is also much smaller.

Finally, with the move to digital assets and private equity tokenised assets gaining traction, the global market may soon self-correct to some extent, pricing these markets more fairly. If these trends take hold then the policy push may prove redundant before it takes full hold. At best, the Accord may serve as a temporary fix. At worst, it could be a misstep driven by desperation.

## A final word

Despite much focus on avoiding conflicts of interest for the sake of good governance, the fiduciaries responsible for these pools of assets now face a direct challenge to their independence and in their actual fiduciary responsibility. Those who consider this mandate to be a fool's errand, and might very well be right, could find themselves a lonely voice, out of their roles, or over-ruled by the state in due course.

Ultimately, the Accord appears less about enhancing member wealth and more about propping up UK plc's image. Nevertheless, as the parable of the emperor's new clothes shows, illusions don't last forever.

The timeline to implementation gives providers breathing space to consider all these factors. However, it seems that once again, the consequences of state interference may mean things do not quite work out as planned—despite their best intentions.



It is worth considering, as DC scheme trustees, whether you would make these allocations without governmental encouragement or if you are doing so because you feel pressured to. It is time for us all to speak up if there is any feeling that member interests are being undermined.

**If you would like to discuss any of these matters further, please get in touch with your usual contact at Cartwright.**

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250 Fowler Avenue  
Farnborough Business Park  
Farnborough GU14 7JP

Marlborough House  
Victoria Road South  
Chelmsford CM1 1LN

T: 01252 894883  
E: [enquiries@cartwright.co.uk](mailto:enquiries@cartwright.co.uk)  
W: [pensiontrusts.cartwright.co.uk](http://pensiontrusts.cartwright.co.uk)

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Registered Office: 250 Fowler Avenue, Farnborough Business Park, Farnborough, Hampshire GU14 7JP

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