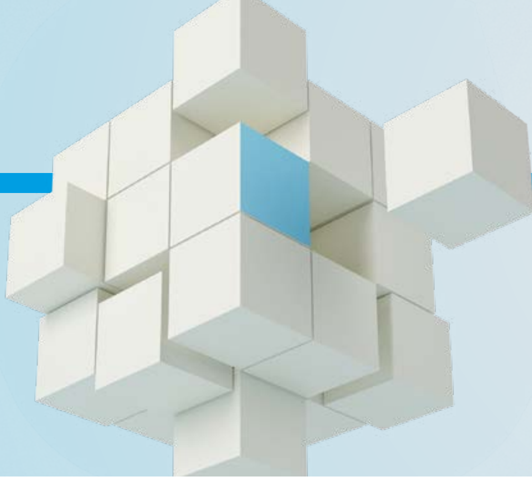

Amundi
Investment Solutions

#22 / December 2024

Trust must be earned

Pension funds letter

Building together smart solutions to face a challenging environment

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Executive summary

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- **P9** Beyond the Numbers: ESG in Action
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New realities, new searches for returns

Amongst other things, 2024 will be remembered for being the year of elections. More voters than ever before, over half the world's population, had the opportunity to express their vote this year. While almost all these votes have now been counted, what the different outcomes will mean both domestically and more globally is only likely to become clear next year. We wait especially with bated breath, to see how Trump 2.0 will play out around the world.

US policy shifts will have repercussions on emerging markets in particular. Asian emerging markets are one of the themes featured in the 2024 Amundi-CREATE pension survey. As pension investors look for new sources of return, both private and emerging markets are gaining traction. Asia is an increasingly important driver of global growth, while private markets are viewed as a source of value creation, providing exposure to innovation. We look at what has been driving, and constraining, pension allocations to these asset classes.

Continuing the theme of private markets, the second article explores how ESG integration is being adopted by private market investors and how a multi-manager portfolio can manage its ESG risk.

As investors seek diversification and additional returns, the securitisation market has been attracting attention. We examine some of the advantages the European securitisation market can offer pension funds and the risks to consider.

Finally, we wrap up with what the latest market moves have meant for pension funding ratios in some of the key markets. Funding ratios are a standard indicator for measuring the health of a DB scheme. As pensions move more and more towards DC systems, how do we assess if these retirement provisions are sufficient? We discuss some of the developments.

What's new & coming up?

November 2024
2025 Outlook
Bright spots in a world of anomalies
Discover the emerging trends and strategies to help make informed decisions in a complex environment.
Read the paper

November 2024
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Save the date for the next Amundi Pension Fund Club! Explore some of the big themes for 2025 at our annual online pension event.

Amin RAJAN
Chief Executive Officer
of CREATE

Monica DEFEND
Head of Amundi
Investment Institute

Where will returns come from? Pensions in a new economic regime

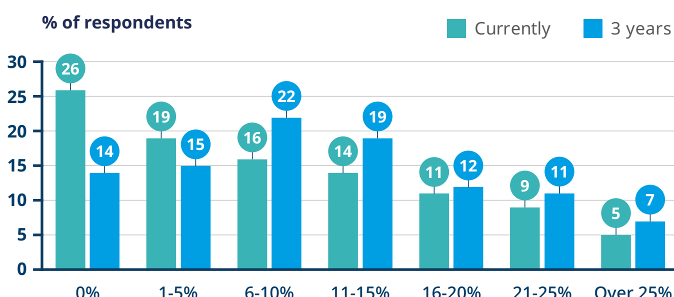
The Great Moderation of the past 25 years was marked by stable economic growth, low interest rates and low inflation. This era was shattered by four pivotal changes: the severe monetary tightening by key central banks to tackle the inflation spike; worsening conflicts in the Middle East and Ukraine; the rise of populism in the West; and the US–China geopolitical rivalry fragmenting global supply chains. However, these rapid changes also create opportunities as capital markets adjust to the new realities. With public equity markets in the West nearing all-time highs, the search is on for good risk-adjusted returns. ***The 2024 Amundi–CREATE global pension survey*** *examines two primary areas: private markets (illiquid assets) and Asian emerging markets. Pension funds worldwide were asked their views on their allocations, plans and predictions for these alternative sources of value.*

Private markets

Private markets on the up, as rates move down

74% of survey respondents currently allocate to private markets, with significant investments in the US, followed by Europe and Asia-Pacific: 49% currently have allocations of up to 15% and another 25% have above 15% (Figure 1.1). This shift towards private assets is expected to continue, with **86% of pension funds anticipating an allocation in the next three years,** as the rate-cutting cycle that began in 2024 is forecasted to improve the outlook for private markets.

Figure 1.1: What is the approximate share of all private market assets in your pension plan's total investment portfolio currently and in three years' time?



Source: Amundi Investment Solutions / CREATE-Research Survey 2024

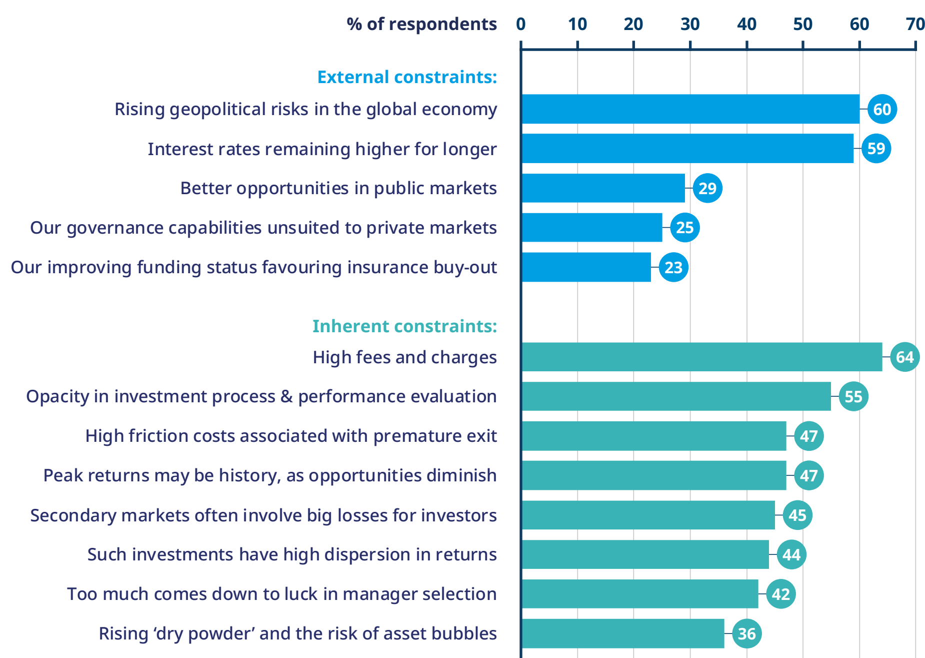
The surveyed pension funds are at varying stages in the adoption cycle: 21% are at the awareness-raising stage, 5% are close to decision making, 22% are in the process of implementation and 52% already have a mature portfolio of different private market assets.

The size of private market allocations correlates with the pension funds' respective asset base, with larger funds having more capacity to invest in illiquid assets.

The motivation for investment is dominated by two principal factors: **Good risk-adjusted long-term returns** remain the top targeted benefit (72%) and achieving **a triple bottom line:** doing well financially, doing good socially and environmentally (56%).

To date, allocations appear to have been constrained by two groups of factors (Figure 1.2), those external to private markets such as rising geopolitical risks (60%), which are difficult for investors to evaluate, or the prospect of interest rates remaining higher for longer (59%), which sparked a major reversal in private asset values. Barriers inherent to private markets are led by high fees and charges (64%), opacity in investment processes (55%), diminishing opportunities (47%) and high friction costs (47%).

Figure 1.2: Which factors have constrained your pension plan's investments in private market assets in the recent



Source: Amundi Investment Solutions / CREATE-Research Survey 2024

How do pension funds approach investment in private markets?

Pension funds have clearly embraced investment in private markets. Many consider themselves to be **long-term buy and hold investors** as 51% of respondents treat private market investments as **part of their strategic asset allocation,** and a further 20% treat them as part of a dedicated stand-alone sleeve in their portfolios.

This focus on the longer term within a policy framework makes **private market assets particularly suitable for ESG investing,** especially for searching out climate opportunities. Many private market companies are at the cutting edge of green technology, which have long gestation periods that public markets struggle to price.

Many of the respondents' allocations to **impact investing** – targeting financial, social and environmental benefits – have been channelled into private markets, especially private equity and private debt. These investments can result in **more effective positive targeted impacts** through direct investing in pure play companies whose business models are solely focused on the chosen themes. The ownership structure and customised covenants also allow for more productive stewardship.

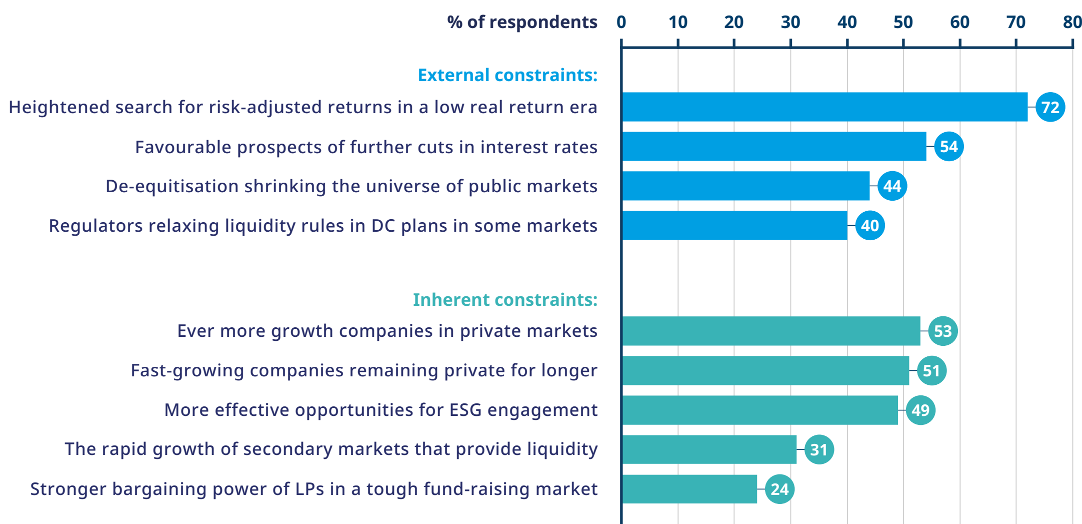
Predominantly, pension funds have been allocating to **stand-alone individual funds** (49%), reflecting the use of funds of different vintages (private equity, private debt) or specific projects and asset types (infrastructure, real estate). The trend indicates a preference for single-strategy specialists, whether they operate as independent boutiques or as part of multi-strategy platforms.

Most pension funds are gravitating towards the less risky, senior segments of the capital structure, which aligns with a conservative investment philosophy. Those with smaller allocations to private markets are **increasingly favouring open-ended multi-asset funds** (14%), which aim to capture the illiquidity premium while managing liquidity constraints. These funds have **gained traction over the past five years,** particularly as pension plans have faced challenges related to the 'denominator effect'—a phenomenon where declining public market asset values lead to an overweighting of illiquid private assets in portfolios.

Search for better returns will drive fresh allocations

Two primary sets of drivers are poised to influence private market investments (Figure 1.3). External drivers include the ongoing **search for attractive returns** in an environment characterised by low real returns (72%), as well as the anticipation of further **interest rate cuts** by central banks (54%). Additionally, the structural **de-equitization of public markets** (44%), marked by significant share buybacks and a declining number of initial public offerings, is prompting pension funds to explore private market opportunities more aggressively.

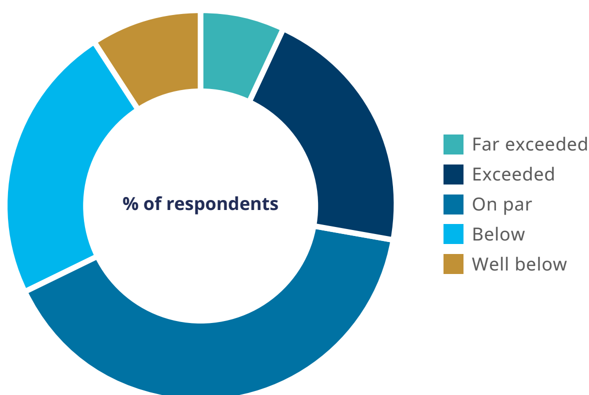
Figure 1.3: What will be the key drivers of your pension plan's interest in private market assets over the next three years?



Source: Amundi Investment Solutions / CREATE-Research Survey 2024

So far, investments in private markets have generally met expectations (Figure 1.4), but asset class and manager dispersion have been large.

Figure 1.4: Have your private market investments met your pension plan's overall investment expectations so far?



Source: Amundi Investment Solutions / CREATE-Research Survey 2024

Within private markets themselves, the increasing presence of **growth companies** in private markets (53%) and the trend of these companies to **remain private** for extended periods (51%) are driving allocations. As we have already seen, there is a **growing emphasis on environmental, social, and governance (ESG) factors** with 56% of respondents targeting a triple bottom line from their private market allocations. In this context, 49% of respondents look to private markets for **more effective opportunities for engagement.** The bilateral nature of legal covenants in private market investments facilitates ongoing dialogue on strategy and ESG issues compared to public markets.

Looking ahead: Continued Interest in Private Markets

In light of these growth drivers, private market assets are expected to continue to attract moderate net inflows, even though **returns are likely to be lower with bigger dispersion.** The market is now likely to be defined by three trends:

1. Return to fundamentals

Investors seek sustainable earnings growth and margin expansion gained from improved business excellence and operating leverage. The illiquidity premium must rely more on the fundamentals of the underlying assets than fluctuating monetary policy tailwinds

2. Rise of secondary markets

With growing emphasis on fundamentals, secondary markets are expected to be a more efficient way of meeting periodic cash flow needs and avoiding forced selling

3. Preference for thematic investing

Direct investing in pure play companies can give access to mega-trend themes and predictable value creation in areas that have a higher likelihood of more positive targeted impacts.

The **focus on quality** is vital for private market assets to sustain and enhance their current distinctiveness in the investment universe. The current approach will remain a pragmatic blending of **opportunity** and **caution**. Successful private market asset managers (known as general partners) will be those who have **learned lessons** from the end of the cheap money era and **reorient their business models** towards what their clients need in a less benign environment.

This shift has reinforced the need for pension funds to select general partners who have credible value creation plans, sound execution capabilities and reduced reliance on the state of capital markets to drive future returns.

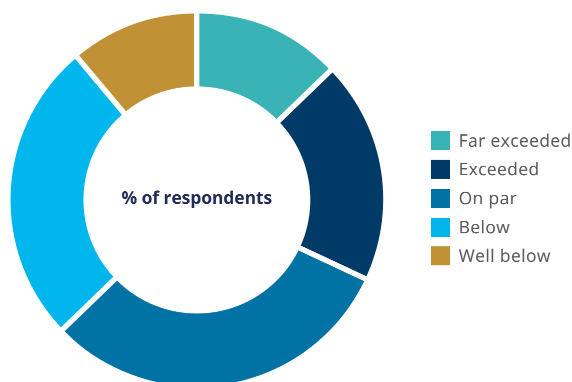
Far and away the most important criterion now being used by survey respondents is a **good track record of delivering clients' financial and ESG goals** (78%). Performance also needs to be backed by an incentive structure in which fees and charges reflect value for money (66%). Another reported key requisite is more transparency around the investment process, performance valuation and the identity of fellow investors (58%).

Asian emerging markets

Not all Asian emerging markets are created equal

The geopolitical rivalry between China and the US is set to fragment the global order into two rival trading and currency blocks. This has cast a shadow over other countries in Asia. On the whole, Asian emerging market (EM) stocks have remained **under-owned,** despite their combined weight of 46% in global GDP. By 2030, Asian markets are expected to contribute 60% of global growth.

Figure 1.5: If you are already invested in Asian emerging markets, have your investments met your pension plan's risk-adjusted return expectations so far?



Source: Amundi Investment Solutions / CREATE-Research Survey 2024

Most respondents are already invested in Asian EM to some extent (Figure 1.5), but the majority have **allocations of no more than 5%**. Geopolitical risks eclipse the favourable economic fundamentals. Investors remain wary of Asian EM assets, particularly eager to avoid a repeat of the 2022 delisting of Russia, as political tensions between China and the US rise. Moreover, the **favourable growth dynamics have yet to translate into big investment gains.**

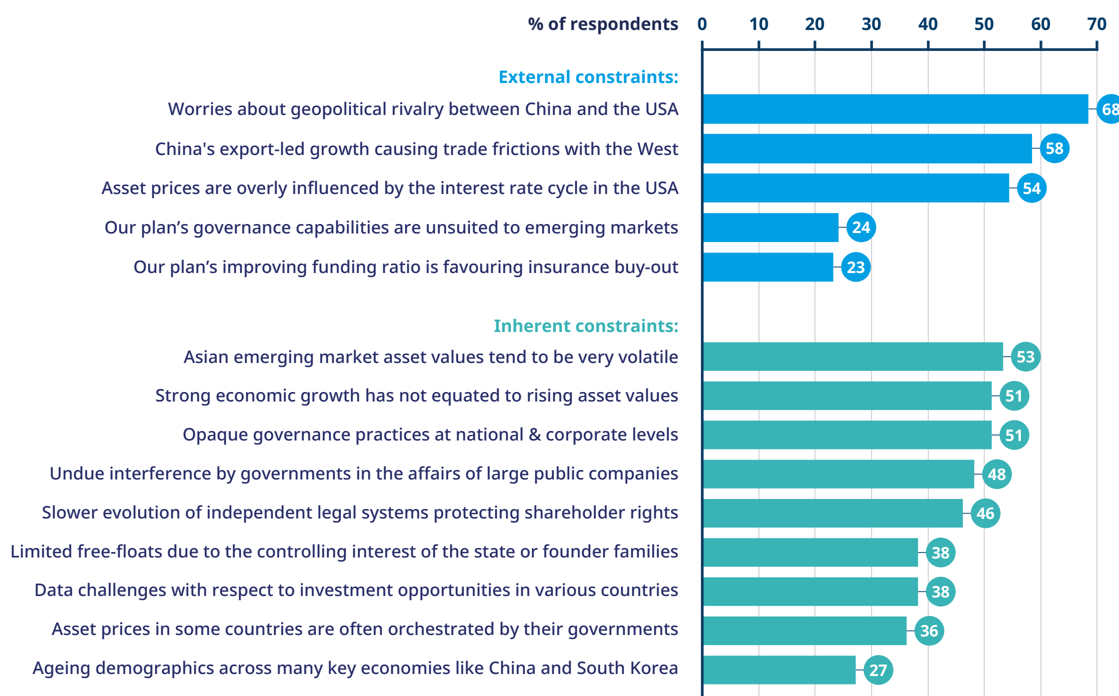
Impressive returns are reportedly based on a **high degree of selectivity.** Some have focused on assets with high intrinsic value, based in countries that are politically stable with a robust rule of law and stronger shareholder rights.

Respondents whose investments did not do well fell into two groups. The first group were seeking prime mover advantage. But the targeted advantage has been slow to materialise. The second group lost out by relying overly on passive funds, where the recent underperformance of Chinese equities has drowned out the positive performance of other countries in the indices.

Various external and internal factors have constrained investors' allocations to Asian EM in the past (Figure 1.6). These are led by the aforementioned worries about the **geopolitical rivalry** between China and the US (68%). **Trade frictions** related to this rivalry have also limited investment (58%). Another external factor has been the **US interest rate cycle.** The higher rates of 2022–23 (54%) hit Asian emerging market assets, as many of their companies had funded their growth with US dollar debt.

The internal factors are concentrated around concerns about high volatility (53%), and the disconnect between strong economic growth and rising asset prices (51%). Some markets also face opaque governance (51%) and government interference (48%) in corporate affairs, affecting investor confidence.

Figure 1.6: Which factors have constrained your pension plan's investments in Asian emerging markets in the recent past?



Source: Amundi Investment Solutions / CREATE-Research Survey 2024

Reforms and realignment weighing on future allocations

Asia's geopolitical upheaval may yet have a silver lining. The **China Plus One** strategy, where companies diversify production out of China, is **creating investment opportunities** in neighbouring countries with strong economic fundamentals..

In the past, although GDP growth in Asian EMs has been significant, this has **not always translated to asset market performance.** A renewed focus on governance reforms from Asian EMs was therefore mentioned by 55% of respondents as a key internal factor driving interest in the region.

Nonetheless, survey respondents **expect only modest increases in allocations** to Asian EM in the next three years. Driving these increases will be a search for **good risk-adjusted returns** (74%), structural opportunities created by the **reorganisation of global supply chains** (61%) also feature strongly, and the falling sensitivity of Asian asset prices to the US interest rate cycle (53%). Reforms to improve corporate governance (55%) alongside favourable growth dynamics (52%) and demographics (47%) are also driving interest.

Investors to become more selective and goal-focused

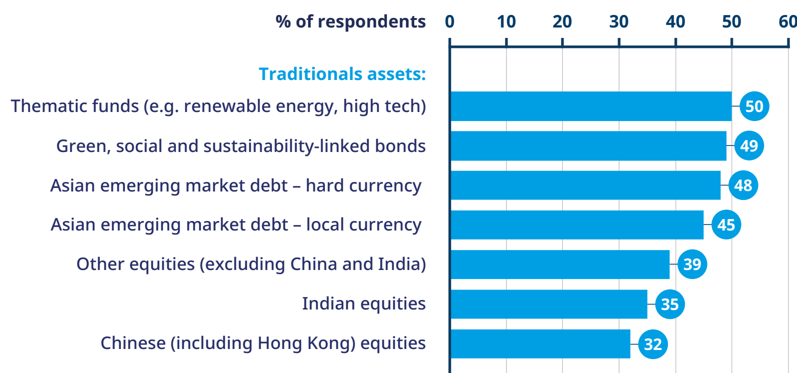
When we look to future allocations, the proportion investing in all Asian EM is likely to **rise from 62% to 76%,** with respondents set to focus on selectivity to reflect the unique dynamics of each country.

For active investment, three avenues are considered:

1. **Direct investment in companies listed in Asian EM** (49%) – to focus on the intrinsic potential to convert growth forecast into earnings
2. **Allocations to developed market companies with high profit exposures to Asia** (43%) – an avenue that offers greater liquidity and transparency, while benefitting from the huge revenues gained from emerging markets
3. **Investment in Asian companies listed in developed markets** (26%) – allowing investors to benefit from familiar and consistent corporate governance, transparency and reporting practices

Within passive investment, 43% of respondents plan to gain access via broad index funds and ETFs focused on Asian EM. **Single country focus funds** are likely to gain traction (30%). This trend is in contrast to the broader current shift towards global equities rather than country allocations. Broad global emerging market index funds and ETFs are likely to be used much less (21%). Once touted as the primary low-cost access to emerging markets, such funds are losing their appeal given the pronounced gap between the best and the worst performing companies and the high company turnover in regular index rebalancing.

Figure 1.7: To which Asian emerging market asset classes is your pension plan expecting to increase its allocations over the next three years?



Source: Amundi Investment Solutions / CREATE-Research Survey 2024

Mega trends (50%) such as AI, renewable energy or supply chain reconfiguration will play a **significant role in new allocations**, to focus on likely future sources of value creation (Figure 1.7). Bonds are preferred over equities, offering a value opportunity and for minimising portfolio volatility. Public markets are likely to prevail over private assets, where interest remains muted as liquidity takes precedence over opportunity.

Survey respondents also perceive the region as offering good opportunities to harvest **'green' alpha.** Countries as diverse as China, India and Indonesia are expected to become major players in the green economy.

In the past, four large markets dominated investment: China, India, South Korea & Taiwan. However **smaller Asian nations are attracting increased attention.** India is expected to displace China as the most popular destination for increased allocations (49%), followed by South Korea (43%) and Taiwan (36%). Vietnam, with its rapidly expanding tech sector (30%), is set to narrow the gap to fourth placed China (34%), followed by Indonesia (24%) and Malaysia (23%), who are benefitting from the growing tech and green expansion and the China Plus One strategy respectively.

When it comes to manager selection, survey participants rank **delivering clients' financial and ESG goals as top priority** (63%), followed by a value-for-money fee structure (59%), a deep talent pool capable of delivering innovative client solutions and strong stewardship (55%) to help deliver on ESG goals. Equally important, managers are expected to have a **strong physical presence in the region** (56%) to ensure managers are well-versed in the cultural and political nuances of the countries concerned.

Amundi-CREATE 2024 survey: Highlights

(% of pension plan respondents)

Private markets
Future increase in allocations and their key drivers

74%
Are currently invested in private market asset classes with varying degree of allocations

86%
Expect to be invested in three years' time

72%
Believe that new allocations will be driven by a heightened search for good risk-adjusted returns

54%
Expect further cuts in interest rates to facilitate the next wave of allocations

Private markets
Asset class and regional outlook over the next three years

55%
Expect to increase their allocations to private debt

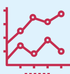
49%
Expect to increase their allocations to private equity

71%
Cite North America as a source offering best returns

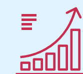
59%
Cite Europe as a source offering best returns

Asian emerging markets
Future increase in allocations and their key drivers

62%
Are currently invested in Asian emerging market asset classes with varying degree of allocations

76% 
Expect to be invested in three years' time

74%
Perceive that new allocations will be driven by a heightened search for good risk-adjusted returns

61% 
Expect the reconfiguring of supply chains in the region to enhance the prospect of better returns

Asian emerging markets
Asset class and regional outlook over the next three years

50%
Expect to increase their allocations to thematic funds covering renewables and high tech

48%

Expect to increase their allocations to hard currency debt

49%
Cite India as the most favoured nation for their new allocations

43%
Cite South Korea as the second most favoured nation for their new allocations

About the survey: each year, Amundi and CREATE interview pension plans to highlight insightful convictions for the year to come. As pension investors transition to a new regime, one question has come to the fore: where will the returns come from? The 2024 edition has a twin focus on asset classes in private markets and Asian emerging markets and asks five questions:

- what are pension plans' current allocations to these asset classes and how are they likely to change?
- which factors have constrained allocations so far and which ones will likely drive them in future?
- what specific investment benefits are being targeted and to what extent have expectations been met?
- how is the mix of components within each of the broad asset classes likely to change?
- which selection criteria will be used when awarding new mandates to external asset managers?

The survey is based on 157 respondents Asia-Pacific, Europe and North America, collectively managing €1.97tn of assets.

Read the full Amundi-CREATE report

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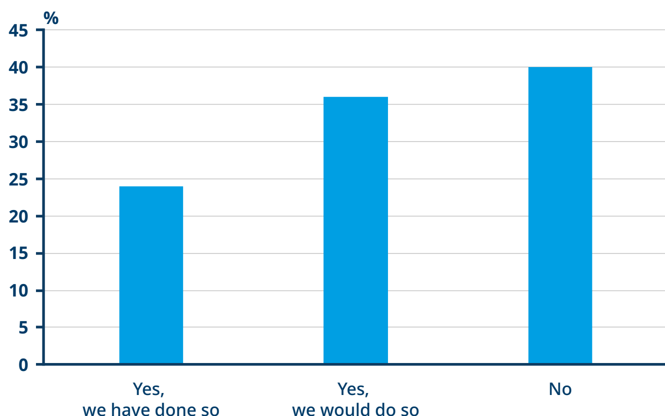
Head of ESG & Impact,
Amundi Alpha Associates

Beyond the Numbers: ESG in Action

As the 2024 Amundi-CREATE report highlights, the private markets asset class is particularly suitable for responsible investing. This article explores how an investor in private assets, such as Amundi Alpha Associates, can approach and refine responsible investment capabilities, as well as the practical steps taken to integrate ESG factors into their portfolio monitoring processes.

Today, investors rightly expect to receive transparent, clear, and comprehensive reporting on the Environmental, Social, and Governance (ESG) aspects of their portfolio. To meet these expectations, proactive engagement with portfolio fund managers is essential to steer their sustainability processes and drive meaningful and tangible change. The alternatives data provider Preqin indicated in their 2024 *ESG in Alternatives* report that 60% of investors would have or have turned down an otherwise attractive investment over **concerns about ESG.**

Would you turn down an investment for ESG reasons?



Source: Preqin's 2024 ESG in Alternatives

Meanwhile, more than 8,300 companies representing all sectors of the economy, including nearly 600 financial institutions representing USD 130 trillion in assets under management, have committed to net-zero targets under the UN's Race to Zero initiative, reflecting a significant shift in corporate accountability. Institutional investors, however, bear an even greater responsibility—not just to demand high ESG standards from their investments, but to lead by example in **driving sustainable progress at scale.**

At Amundi Alpha Associates, we are committed to constantly building on the ESG foundations that we first established nearly 20 years ago. As an institutional investor, we have the ability to promote widespread, sustainable change that can benefit society. Furthermore, as a manager of multi-manager portfolios, we view the integration of ESG factors as **essential to our fiduciary duty.** Eric Tazé-Bernard of the Amundi Investment Institute notes in a recently published paper on responsible investing in private equity[1] that responsible investing aligns with investors' objective to maximise the value of companies upon exit: "If the invested company's future prospects are hindered by environmental or social risks, or if its governance is inefficient, its value will clearly be negatively affected." By thoroughly embedding ESG into our due diligence process, we can build more valuable, resilient portfolios for our stakeholders.

The interconnected sustainability challenges we face demand urgent and collaborative action, which further extends to robust and standardised monitoring practices. Without these, it becomes impossible to audit and assess progress meaningfully. **Transparent measurement** and **consistent ESG reporting** are the cornerstones of accountability and improvement of a responsible investing framework.

1. https://research-center.amundi.com/article/responsible-investing-private-equity

Establishing a Robust ESG Monitoring Framework

At the heart of effective ESG monitoring lies the **establishment of clearly defined goals.** For direct managers, these goals are often company-driven and tailored to the specific needs of the companies within their portfolio. Private equity (PE) managers, in particular, have a unique capacity to influence change by actively shaping company-level ESG policies. It can also be stressed that governance, one of the three pillars in ESG investing, is an essential component of PE as, according to General Partnerss interviewed by Amundi, **"PE is about governance"**, and "Governance is key as you must have accountable leadership first to get the rest right". Through board representation, operational oversight, and capital allocation decisions, they can **drive measurable improvements** in areas such as emissions reduction, governance frameworks, and social responsibility. This **proactive approach** not only benefits individual portfolio companies but also contributes to broader, systemic progress in addressing global sustainability challenges.

In contrast to a direct fund manager, a multi-manager platform often spans hundreds or even thousands of underlying companies, but its **influence is indirect,** exercised primarily through the portfolio fund managers. This structure makes the assessment of a portfolio fund manager's ESG practices a **critical component** of the multi-manager **ESG due diligence process** – see also the 2024 Amundi-CREATE Research[2]. Evaluating a fund manager's ability to implement, monitor, and report on ESG data is **key to ensuring meaningful outcomes at the look-through company level.**

Turning Data into Direction – Progress over Perfection

At Amundi Alpha Associates, we recognise the **importance of this indirect influence** and have embedded **rigorous ESG assessments into our due diligence framework.** All short-listed portfolio fund managers are required to complete a comprehensive **ESG due diligence questionnaire.** This evaluation delves into the fund manager's capacity to monitor and measure greenhouse gas (GHG) emissions and explores the climate commitments they have made, among other topics. By setting clear expectations and conducting thorough assessments, we ensure that the ESG practices of our portfolio fund managers align with our overarching sustainability goals.

We believe it is important to have an approach that prioritises identifying a manager's capacity for improvement rather than expecting perfection from the outset. Recognising that the ESG regulatory landscape is continually evolving, we understand that **many private markets managers are still refining their ESG reporting frameworks.** To address this, we have designed our processes to first assess a manager's baseline ESG capabilities, creating a **foundation for tracking** their progress over time. By collecting consistent and reliable data annually, it allows us not only to build a robust track record but also to enhance our ability to make informed decisions and evaluate meaningful advancements in ESG performance.

Tailored and Transparent ESG Reporting

In addition to maintaining **continuous dialogue** with the portfolio fund managers, the annual ESG questionnaire—now in its fourth year—forms the cornerstone of our ESG monitoring efforts. Given the nature of our funds-of-funds portfolio, transparency is prioritised as a key tool in our reporting campaign. We encourage managers to report as much data as possible, while we handle the aggregation, standardisation, and analysis. By minimising the reporting burden and complexity for our managers, we collect richer datasets and conduct a more meaningful assessment of our portfolio. This approach not only helps identify and mitigate ESG risks but also enables us to work collaboratively with portfolio fund managers to enhance their processes and seize opportunities for sustainable growth.

The ESG questionnaire is **specifically tailored to our multi-asset portfolio,** encompassing private equity, private debt, and infrastructure equity. It is primarily structured around the mandatory Principal Adverse Impact (PAI) indicators outlined in the Regulatory Technical Standards (RTS) of the Sustainable Finance Disclosure Regulation (SFDR). Acknowledging that certain data points may be less relevant for some portfolio fund managers depending on asset class and investment strategy, the questionnaire is customised to ensure the collection of relevant, actionable insights. This process is carefully adapted to reflect each manager's geography and strategic priority.

Once responses are received, the data undergoes a rigorous process of cleaning, analysis, and reconciliation through consistency and logic checks. Data cleaning is critical to enhancing the accuracy and reliability of the information, as well as strengthening the robustness of the statistical model estimates.

Internal consistency checks are applied to each response to ensure that data points align with other information reported by the manager, helping to identify and address any contradictions within the questionnaire itself.

Simultaneously, the questionnaire undergoes a series of external **consistency checks,** leveraging information from other data sources to validate and reconcile the data disclosed by companies with information reported elsewhere. For instance, if a manager erroneously indicates in the questionnaire that they do not have an Exclusion Policy, we cross-reference this with documentation from our initial due diligence. This process helps identify whether the discrepancy is due to a manual error, a misunderstanding of the question, or is indeed an accurate reflection of the manager's practices.

2. Amundi-CREATE 2024 - Seeking returns in private markets and emerging markets in a disruptive era

The checks are designed to identify and address misreported data points. Wherever possible, we **engage** directly with managers to clarify discrepancies and correct the data as needed. Significant outliers that could distort statistical models are excluded. A common example involves carbon emissions: some managers report emissions at the group level, even when our investment is limited to a specific sub-entity responsible for only a fraction of those emissions. In such cases, the group-level data must be excluded or scaled appropriately to ensure accurate calculations.

To further streamline the data collection process, we have expanded our accepted reporting formats to include the ESG Data Convergence Initiative (EDCI) template and the European ESG Template (EET), alongside our online platform. This broader approach has significantly **improved response** rates to our data requests, though it has also increased the complexity of data processing. This underscores the **importance of digitisation.**

Over the past three years, we have transitioned to a proprietary in-house programmed tool that automates critical tasks such as validation and outlier detection, enabling **greater efficiency and accuracy** in our processes.

Our reporting campaign concludes with the distribution of individual ESG reports to our investors, evidencing our mission to facilitate clear, measurable, and transparent reporting across our portfolios.

Applying ESG Data to Mitigate the Climate Crisis

Building on these advancements, we have **established a baseline for the reporting capabilities** of our portfolio fund managers, with the intention of generating more **qualitative insights** and **comprehensive assessments** of the ESG data provided. As the **market standard for ESG reporting requirements has evolved**, we want to ensure that our monitoring methodology not only reflects best practice, but also reflects our raised expectations for the level of ESG reporting we expect from our portfolio fund managers.

Aided by three years of data and a robust algorithm-driven scoring system, we now have enough context to move beyond simply tracking completion rates and instead can begin evaluating the substance and quality of the information provided by our portfolio fund managers.

Our long-term goal is to derive meaningful, actionable insights from the data we collect, ensuring it informs tangible decisions and drives impactful outcomes. After all, **private capital plays a pivotal role in accelerating sustainable change,** and the quality of the information we gather is key to unlocking its full potential.

We believe that enhancing sustainability is a global challenge that demands **collective action** if we want to successfully mitigate its effects. By developing a more rigorous, data-driven approach to evaluating ESG, and consequently using **quantitative analysis to better identify and manage ESG risks** in our portfolio, we can play our part in contributing to measurable progress toward a more sustainable future.

About Amundi Alpha Associates

Amundi Alpha Associates is the private markets multi-manager business line of Amundi Alternative & Real Assets, with a combined team of 70 based across Zurich (HQ) and Paris. The team manages private equity, private debt, and infrastructure funds-of-funds as well as tailor-made investment programs (managed accounts) for a global, institutional client base.

Hubert VANNIER
Head of Secured Assets

With contributions from:
Amadou Loum & Geoffrey Sauwala

European Securitisations: Risk and Opportunities for Pension Funds

European Securitisations have recently attracted attention, with 2024 to date seeing record volumes of issuance since the Great Financial Crisis[1]. European regulators have also shown strong support through several recent reports (from Noyer, Letta and Draghi), which have led to a public consultation from the European Commission. We review the opportunities and the associated risk of European securitisations for pension funds.

Definition

Securitisations are defined by two main features in European regulation[2]:

1. Use of collateral

Payments to investors are provided by one or several assets. The vast majority of securitisations rely on pools of loans to households or corporates.

2. Subordination of the liabilities

The liabilities of European securitisation vehicles are distributed among different notes, or "tranches", reflecting the priority of cashflow allocation, i.e., the subordination of tranches.

Returns

Unlike in the US, most European securitisations pay floating coupons, linked to a 3-month or 1-month index. Due to the low interest rate duration, their main sensitivity relates to credit. Securitisation credit spreads are significantly wider than those of corporates with similar ratings.

Figure 1: Examples of European Securitisation and iTraxx Spreads

	AAA	A	BBB	BB
Dutch RMBS Snr FL 5Yr	48			
Dutch BTL RMBS AAA FL 3 Yr	79	162	265	
Consumer Loan EUR Snr FL	79			
Consumer Loan A Euro FL 3 Yr	170			
UK Prime AAA 3Y SONIA	48	130		
UK BTL AAA 3Y SONIA	85			
UK Autos AAA GBP FL 2 Yr	58	170		
EURO CLO	97.5	225	363	595
iTraxx Main / Xover			55	293

Source: JP Morgan, Bloomberg iTraxx. 8/11/2024

Default Risk

Contrary to market efficiency theory, wide European securitisation spreads are not consistent with their actual default rates, which have been historically much smaller, including during the 2008 Crisis. For example, for collateralised loan obligations (CLOs), it is important to distinguish between structures issued before and after the GFC. Both have demonstrated high robustness, with no defaults for structures issued since 2010 (Figure 2).

1. €112.9bn year-to-date publicly placed securitisations as of end of September 2024. Source AFME Securitisation Data Snapshot Q3 2024.
2. See article 2 of European regulation EU 2017/2402.

Figure 2: S&P European CLO Default History, 2001-2023

	EUR CLOs (2001-2022)	EUR CLOs (2001-2022)	EUR CLO 1.0 (2001-2009)	EUR CLO 2.0 (2010-2023)
Original Rating	Total Tranche Number	Number of defaulted tranches	Number of defaulted tranches	Number of defaulted tranches
AAA	1327	-	-	-
AA	1144	-	-	-
A	843	-	-	-
BBB	863	4	4	-
BB	739	17	17	-
B	485	1	1	-
Total count	**5401**	**22**	**22**	**0**
Cumulative default		**0.41%**	**1.5%**	**0.0%**

Source: S&P, Default transition and recovery: 2023 Annual Global Leveraged Loan CLO default and rating transition study

Securitisation Premium

Three main reasons explain this significant excess spread relatively to expected loss:

1. Uncertain cashflow timing

Borrowers of the underlying loans, especially mortgages, or sponsors, notably for CLOs and Commercial Mortgage-Backed Securities (CMBS), have the right to repay the loan principal before its maturity. This **timing repayment uncertainty** may put off investors with fixed maturity constraints (e.g., Target Maturity Funds…). This uncertainty is mitigated by several factors. For example, CLOs and CMBS maturities are limited by provisions restricting non-call and re-investment periods and by the maturities of the underlying loans.

The floating rate nature of the coupon also means price impacts are linked to the potential spread change. Prepayment risk and the consequential reinvestment risk, occurs during significant spread tightening. The opportunity cost of this (possible) situation has to be balanced with the (certain) benefit of the initial investment in high-spread securitisations. The wide spreads of CLOs allow a cushion to be progressively built against this risk that has proved **effective in recent volatile periods.** Conversely, the extension risk is limited by the medium-term maturities of most of the underlying loans (excluding residential mortgages): typically, less than 7 years for consumer, auto and leveraged loans.

2. Due diligence constraints from securitisation regulations

Not all investors are able to analyse securitisation structures, especially the varying cashflows allocation rules (waterfall). Even for the most senior tranches of high-quality securitisations, detailed pre-trade analysis and on-going monitoring are **mandatory** under the European and UK regulations. This may deter investors if they are reluctant to dedicate sufficient resources. For institutional investors, the **regulatory burden** of pre-trade due diligence and on-going monitoring can be managed by delegating these responsibilities[3].

3. See article 5.5 of the European Securitisation Regulation.

3. Punitive prudential treatment

Following the subprime crisis, European and UK regulations have been significantly tightened, especially around capital charges and the liquidity treatment of securitisations for banks. These costs de facto exclude most European insurers from the non-senior, non-STS or long-dated tranches.

For institutions that are not submitted to the Solvency 2 standard approach, like pension funds, the **exclusion of competitors** can be an advantage.

Our expectations for securitisations

Although past data demonstrate the historical robustness of securitisations, we expect future returns to be linked to the **fundamental performance** of the underlying loans.

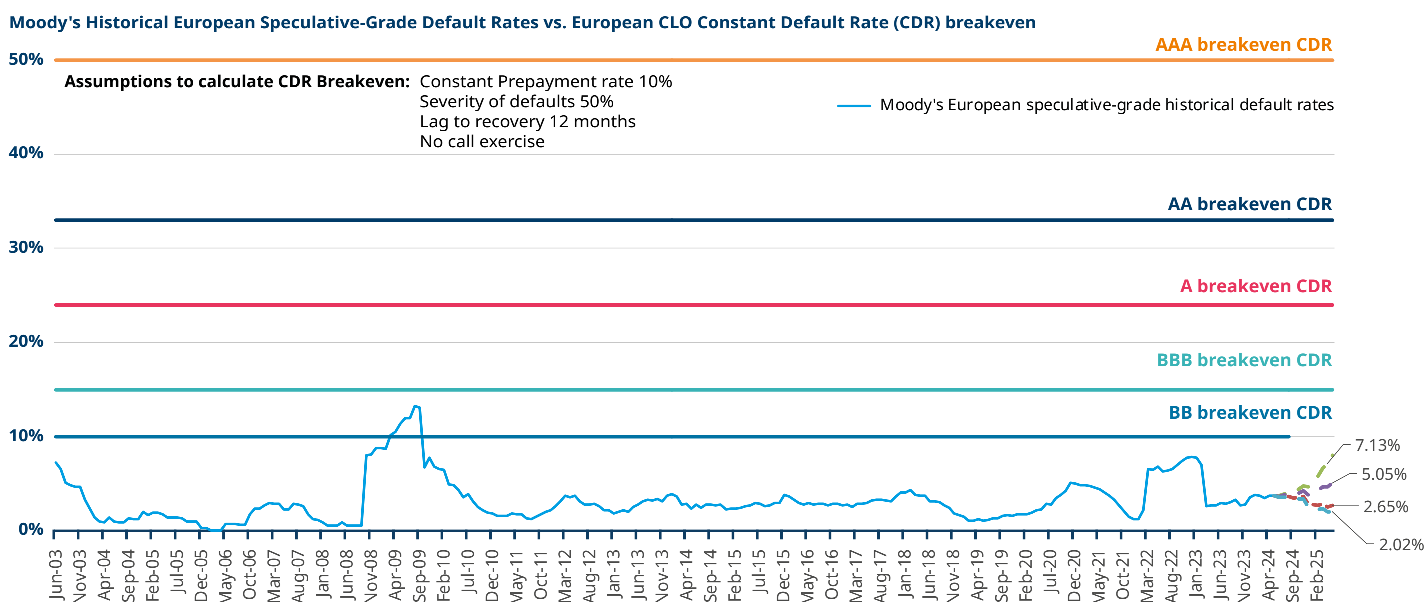
Three main borrower types exist in this context:

- **Households:** for Residential mortgage-backed securities (RMBS), consumer loans and credit cards, most auto loans
- **Corporates:** for CLOs, trade receivables and whole loans securitisations
- **Commercial Real estate funds:** for CMBS

1. **Household loan defaults are highly correlated with unemployment.** In both the UK and continental Europe, unemployment figures are at historical lows and we expect persisting labour markets tensions will shield Europe from a surge in unemployment in 2025.
2. **Leveraged loans are used in CLOs** and are often issued by medium-size corporates with a high-yield profile, typically B-rated and often belonging to non-cyclical sectors.

Post-crisis CLOs, (CLO 2.0), benefit from **improved structural features.** Investment grade and BB tranches are designed to withstand extreme default rates. The breakeven Constant Default Rate for the BB tranches typically stands at 10%, meaning the rate has to be on average above this threshold for the remaining life of the tranche for it to incur a loss.

Figure 3: Moody's Historical European Speculative-Grade Default Rates vs. European CLO Constant Default Rate (CDR) breakeven



Source: Moody's, Intex, Amundi

Due to their spreads and their ability to sustain default rates of the same magnitude as during the GFC, IG tranches of **CLOs** are currently our **favoured type of securitisation.**

3. CMBS and whole loan securitisations

We are cautious on both CMBS and whole business securitisations as they rely on specific risk factors which can make refinancing and default risk difficult to assess due to:

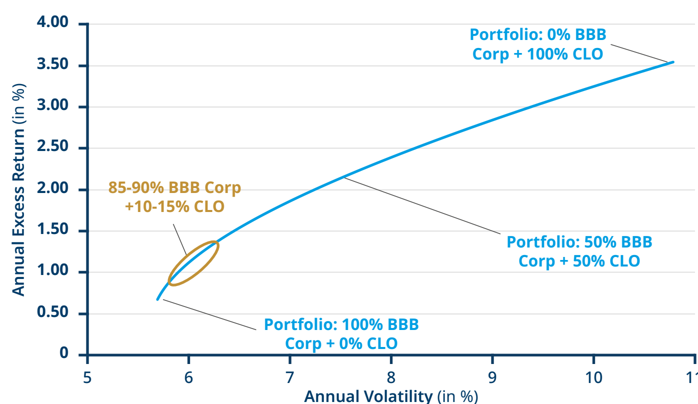
- Asset price cyclicity
- Sectoral changes that may affect specific assets
- Concentration of risk focused on a specific business or properties, e.g. commercial real estate currently suffers from adverse conditions, complicating the refinancing of high LTV loans.

Risk / Return gain in a diversified credit portfolio

Securitisations can **significantly improve the performance** of a credit portfolio, especially through including CLOs that benefit from the largest securitisation spreads. Figure 4 demonstrates how European CLOs and BBB corporates may be used in a portfolio.

A 15%/85% split of CLOs to BBB corporates has potential to optimise risk/return up to this proportion, as additional excess return is obtained with a limited increase in volatility of the portfolio.

Figure 4: Excess annual returns and volatility of portfolios blending BBB Corporate and CLO



Source: Bloomberg, Palmer Square BBB European CLO Index, ICE BofA BBB Euro Corporate Index, 01/2018 – 10/2024, Amundi calculations.

Liquidity

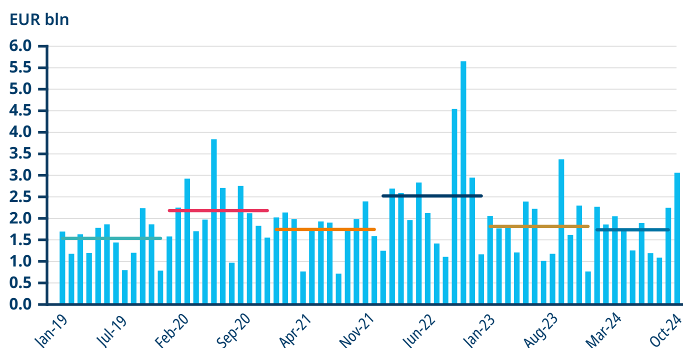
The market size of European securitisations, although smaller than the US, is important, totaling €538bn of placed issuances, of which €245bn are CLOs[4].

Even if some market participants may prefer to hold securitisations long-term, others often implement active management. This allows for **opportunistic purchases,** especially when sellers are in need of liquidity, as demonstrated during the UK mini-budget crisis.

4. Source Morgan Stanley, European ABS Chartbook as of November 5, 2024

In October 2022, trading activity recorded its highest levels, estimated to be in excess of €20bn over a few weeks, almost half executed through public auctions (BWICs for Bid Wanted in Competition).

Figure 5: 2019-2024 European ABS Public sales auctions (BWICs)



Source Morgan Stanley, European ABS Chartbook as of November 5, 2024

Although prices were impacted by the exceptional surge in paper, constrained sellers were able to obtain liquidity. This **extreme liquidity stress test** of the European securitisation market has demonstrated both the existence and the reasonable cost of such **immediate liquidity.**

ESG assessment

As securitisations rely on specific assets for collateral, ESG assessment can be **relatively transparent.** For example, for an auto loan securitisation, the ESG score of a pool can be assessed using the CO2 emissions of the financed cars, or a proxy like the motor type compared to the whole market.

Similarly, the Energy Performance Certificate of the financed properties can be used to assess the mortgage's environmental value. The European Green Bond framework can also be used to recognize the value of securitisations with a green **use of proceeds** commitment from the seller of the loans.

Unfortunately, not all these data are public and they must be gathered by the portfolio manager to ensure fair comparison.

Business Case

Implementing a dedicated CLO fund for a pension fund

In order to capture the CLO spread premium, one of our pension funds clients made the decision to invest in a dedicated fund in December 2023. To **limit the volatility** of the fund and maintain a **high-grade** average rating, the investments are focused on AA to BBB rated tranches with a maximum of 25% of BBB tranches.

Figure 6: Portfolio metrics at purchase during ramp-up

Rating category breakdown	Ramped portfolio breakdown	WA Discount Margin over Eur3m	WA yield to worst (%)
AA	25%	220	4.90
A	50%	270	5.43
BBB	25%	402	6.81
Portfolio	100%	**293**	**5.64**

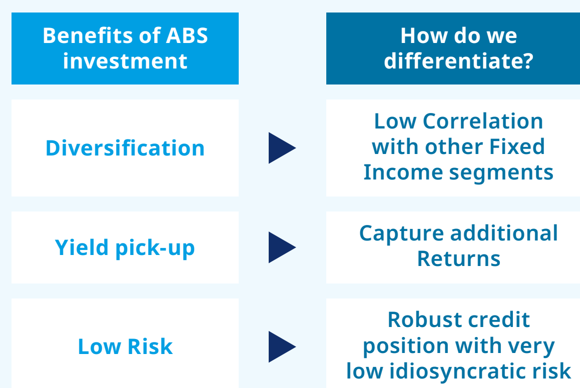
Source: Amundi

The portfolio was fully invested within a few months using both primary and secondary markets, with a dominant share (63%) for the former given the long investment horizon of the client.

The portfolio is **diversified** across country and sector, reflecting the structural diversification of CLOs across the European leveraged loan market.

Client benefits

- **Diversification:** Historical 1-year return correlation of 0.46 between BBB corporates and CLOs[5]
- Robust credit position with very **low idiosyncratic risk** (No expected loss even in a GFC-like stress on IG rated tranches)
- Capture of **additional returns** across traditional FI market with an annualized IRR since inception of 7.9%[6]



5. 1-year correlation of ICE BofA BBB corporate index with Palmer Square European CLO indices reflecting the rating structure of the portfolio as of end of October 2024. Source Bloomberg.
6. Amundi calculation.

Benjamin BRUDER
Senior OCIO Advisor,
Amundi

Solid equity performances keep funding ratios on a high

Despite experiencing volatility in Q3 2024, markets demonstrated resilience with largely positive returns. The decrease in liability discounting rates in Q3 compensated these good performances, and funding ratios have been mostly stable over the period, still at comfortable levels.

Market review: Resilience despite some volatile periods

The third quarter of 2024 was characterised by a generally positive performance across most asset classes, with both equities and bonds delivering robust returns despite a volatility spike in August. Between June and October, the MSCI World Equity Index rose by +4.3% in net USD terms, with US equities leading the charge. The S&P 500 gained +5.9% in Q3, reaching an all-time high in mid-October before a sell-off at the end of the month. This **upward momentum** was supported by strong corporate earnings, particularly in the financial sector, which exceeded market expectations.

In the bond markets, the evolution of long-term interest rates played a crucial role in shaping market dynamics. Throughout Q3, US Treasury yields for long-term bonds experienced a significant decline, with the 10-year yield falling from 4.40% at the end of June to 3.78% by the end of September. This decline was largely driven by the Federal Reserve's decision to cut rates by 50 basis points in September, signaling a **more accommodative monetary policy** stance in response to weakening economic indicators. However, in October, stronger-than-expected economic data led to a reassessment of future rate cuts, with the 10-year yield rising to approximately 4.3% by the end of the month. This shift reflected **growing concerns** about inflation and the potential for a more aggressive monetary policy stance moving forward.

In the Eurozone, the European Central Bank (ECB) maintained a **cautious approach** to monetary policy, with the 10-year German Bund yield experiencing a similar trend. The yield fell from 2.6% end of June to around 2.1% by the end of September, but saw upward pressure in October as **inflationary concerns resurfaced,** leading to a rise in yields to 2.4%. The Euro experienced mixed performance against the US Dollar, strengthening by 3.9% in Q3 but facing pressure in October as the dollar rebounded.

In the UK, the Bank of England (BoE) cut its key interest rate by 25bps to 5.00% in August, marking its first reduction since the pandemic began. The yield on the 10-year UK Gilt also saw a slight decline (-20bps in Q3), reflecting the broader trend in long-term rates. However, as economic data improved, the yield began to rise in October, with a +45bps increase for the 10-year Gilt reflecting market expectations of a **more resilient economy.** The GBP weakened against the USD in Q3 but showed resilience in October, gaining 3.7% as the market adjusted to the reduced likelihood of rapid rate cuts.

Inflation and economic indicators played a **crucial role in shaping market** sentiment throughout the quarter. In the US, the Consumer Price Index (CPI) slowed to 2.5% in August, with core inflation at 3.2%. The labour market showed signs of strength, with unemployment at 4.1% in September. Following the election of Donald Trump, market **dynamics may shift** as investors assess the implications of his policies on fiscal and monetary strategies.

Low impact on pension funding ratios

As Figure 1 shows, these markets movements had a **limited impact** on pension funding ratios in the third quarter: On one hand, decreasing interest rates had a negative impact though the increased liabilities valuations, but good equity performance mostly compensated for these adverse conditions. All in all, funding ratios slightly decreased in Europe (-1%) and remained unchanged in the US during Q3. From end-September to mid-November, the rebound in interest rates, especially in the US due to Trump's election, combined with rather positive equity markets have **positively impacted pension funding.**

Figure 1: Pension Funding ratios

	31/12/2019	31/12/2020	31/12/2021	31/12/2022	31/12/2023	31/03/2024	30/04/2024	31/05/2024	30/06/2024	31/07/2024	31/08/2024	30/09/2024
Netherlands	104.30%	100.20%	114.30%	115.79%	114.60%	116.70%	117.50%	119.00%	120.39%	118.94%	119.52%	119.40%
UK	99.20%	95.50%	107.70%	136.47%	142.80%	146.50%	148.80%	149.41%	149.39%	148.50%	148.22%	148.43%
US	86.80%	87.90%	95.50%	98.20%	97.80%	100.20%	100.40%	100.70%	100.90%	100.80%	100.70%	100.90%

Sources: - UK data: Purple Book, PPF S179 funded status. - Netherlands data: Dnb - US data: Aon Pension Risk Tracker

The average situation of DB plans is still **very positive.** Currently, it seems that most plans will be able to pay their current pensioners rights with little or no additional contributions. Additionally, if we also consider the current shift from defined benefits to a defined contribution framework, future pension accruals (i.e. services cost) are on a downward trend. Indicators tend to show that the sustainability of the DB system is on course financially.

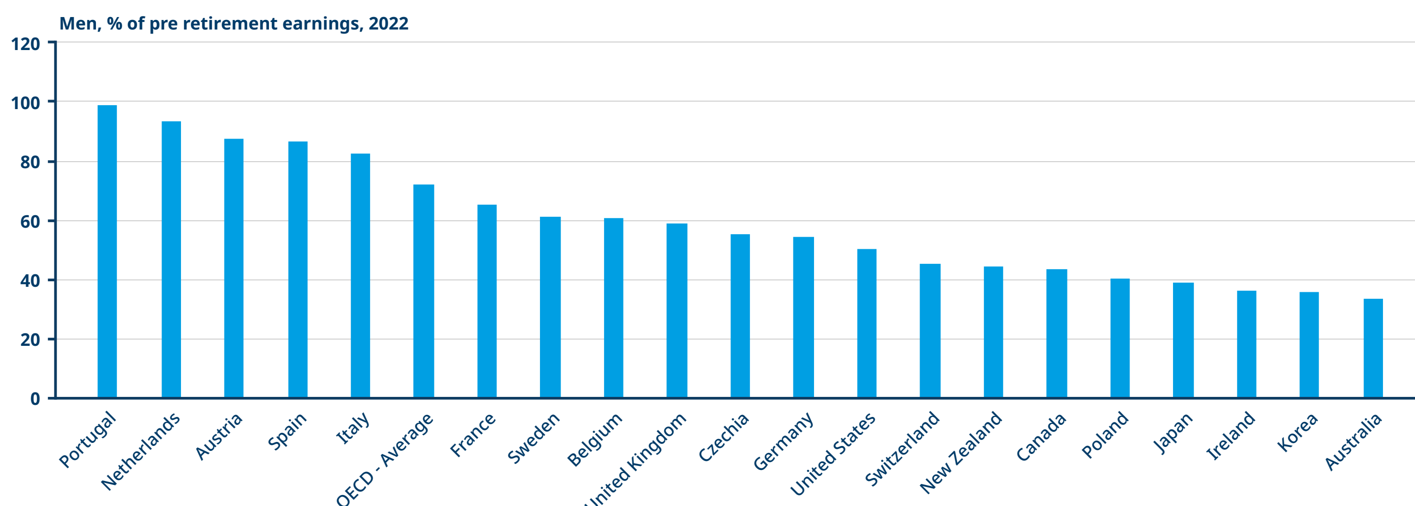
Lack of standardised pension adequacy measures for DC Schemes

But these funding indicators only address part of the retirement system. We still **lack international** standardised and commonly accepted **indicators for defined contribution** plans. In the DC universe, risks are supported by the members. Thus, the major issue is the level of pension they will be able to secure at retirement. Will it be enough to **ensure good living standards?** The "pension adequacy" concept refers to this issue. The measure of expected replacement ratio can be a good indicator: For example, by considering all pillars of the pension system, what monthly pension can be secured at retirement as a proportion of final salary?

But we face **several hurdles** to derive a synthetic pension adequacy measure: As an illustration, DC pensions are individualised, and aggregation can hide huge discrepancies within a population. Secondly, the calculation of the **expected pot at retirement** heavily depends on investment choices and capital market assumptions, which can **vary significantly** from one provider to another. In addition, the **adequacy concept can differ** from one country to another depending on the relative importance of the first, second and third pillars.

Many tools have been developed by providers to simulate the individual outcomes of DC plans. The UK government started the pension dashboard program, to provide each individual a centralised, but personal portal[2]. Meanwhile, Dutch pensions are facing the reverse problem, namely the translation of defined benefits to a current lump sum in the context of their pension reform[3]. Also, many studies have been performed concerning this pension adequacy issue in the aggregate countrywide populations[4], mostly for the current retirement age cohort **(see Figure 2)**. But a **reactive and standard measure** like for DB pension funding ratios has **yet to be developed for DC.**

Figure 2: Net pension replacement rates for mandatory schemes only



Source: OECD Data Archive

2. See https://www.pensionsdashboardsprogramme.org.uk/
3. See Amundi Pension Funds Letter 18 for context on this reform
4. See European Union 2024 pension adequacy report for example

2025 Outlook

Main convictions for 2025

We are in an unconventional economic cycle phase, characterised by a positive outlook alongside anomalies like market concentration and excessive debt levels. While global macro liquidity supports riskier assets, growing policy uncertainty and geopolitical tensions highlight the need for greater diversification.

1. A benign global economic outlook unfolds

The global economy is expected to soften in 2025. The US economy will moderate due to cooling domestic demand and labour market conditions. Disinflation may persist, but inflation risks loom. Europe is positioned for a modest recovery, with strategic investments in focus. Emerging markets are likely to maintain a growth premium over developed.

2. Emerging Asia posts robust growth, with growing regional ties

Emerging Asian economies are enjoying strong growth, driven by the dominance of their IT supply chain and supportive fiscal and monetary policies. External demand and trade within the region will enhance their resilience and connectivity.

3. Geopolitics is increasingly shaping the economic backdrop

Escalating geopolitical tensions, increased economic frictions, and ongoing conflicts will require companies to form new partnerships and relocate their operations to mitigate risks. The global reordering will generate opportunities in the new beneficiaries.

4. Income gains traction

As inflation decelerates to long-term averages, central bank policy will continue to become less restrictive. The gradual return to neutral monetary policies, combined with the low probability of recession, will emphasise bonds' income-generating function.

5. Beyond mega caps: looking at Japan, value in Europe and sectoral opportunities

A positive backdrop for earnings, coupled with good macro liquidity, is positive for equity. However, valuations are stretched, particularly in US mega caps.

6. Private markets are lighting up, with infrastructure in focus

Private markets present attractive investment opportunities amid decelerating economic growth and expectations of more interest rate cuts, with a particular emphasis on infrastructure due to its strong growth outlook.

7. Time to be pro-risk and explore different axes of diversification

The economic backdrop offers bright spots in risky assets, but markets are underestimating the challenges. The macroeconomic outlook, high valuations and escalating geopolitical tensions warrant more nuanced diversification on multiple fronts.

Exploring different axes of diversification

Volatility diversifiers
Brace for ongoing volatility in rates and rising equity volatility amid high earnings expectations.

Liquidity diversifiers
Seek opportunities across the liquidity spectrum amid pricey markets.

Macro / Geopolitical diversifiers
Consider macro and geopolitical risks, especially related to inflation.

1

Volatility diversifiers: Equity **volatility** strategies, market neutral **hedge funds** and **absolute return** strategies (equities, bonds, currencies)

2

Liquidity diversifiers: **Leveraged loans, private debt** and **infrastructure**

3

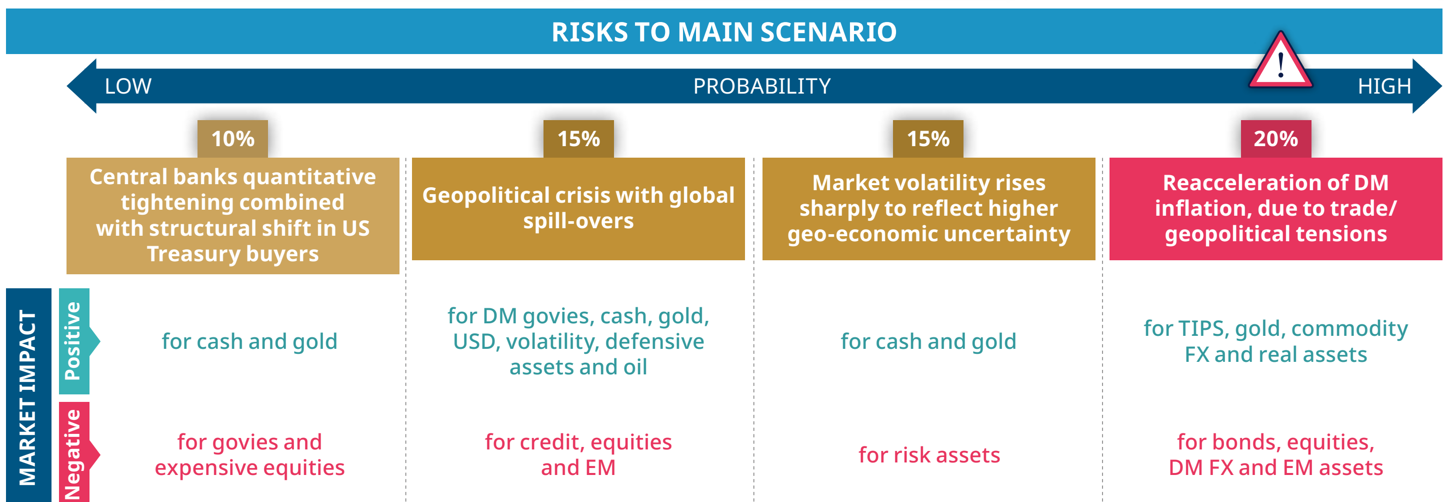
Macro / geopolitical diversifiers: **Money markets, gold, metals, inflation strategies***

Read the full Outlook

2025 Outlook

Main and alternative scenarios

	MAIN SCENARIO Resilient multi-speed growth PROBABILITY **70%**	DOWNSIDE SCENARIO Renewed stagflationary pressure PROBABILITY **20%**	UPSIDE SCENARIO More disinflation with productivity gains PROBABILITY **10%**
GEOPOLITICS	• Rising tensions and ongoing geo-economic fragmentation including protectionism and sanctions. • Disruptive trade policies and re-routing of global supply chains as a reaction to tariffs. • Ukraine-Russia: ongoing fighting, but ceasefire odds increase. • Middle East: talks and conflicts likely. • China-US: decline of relations. • US-Europe relations under pressure.	• Autarchical new alliances challenge advanced economy democracies: new & escalating conflicts. • Countries forced to choose US vs China. Global trade begins to decline.	• Geopolitical risk subsides as conflicts come to a close. • Shifting power dynamics reshape global trade, fostering balanced growth and prosperity.
INFLATION & POLICY MIX	• Disinflation trend to continue, but upside inflation risk remains. • Developed Market central banks reaching their neutral rates in 2025. • Most EM CBs at peak rates. • Different fiscal policies: US might be under scrutiny with a second Trump presidency; EU consolidating; China expansionary.	• More persistent inflationary geopolitical trends advocate a U-turn in monetary policy. • Fiscal debt ballooning fuels the cost of debt.	• Stabilisation of inflation around central banks' targets (and not an issue if slightly above as inflation expectations remain anchored).
GROWTH PATH	• Back to potential growth. • Resilient multi-speed growth: modest recovery in Europe, mild US deceleration but higher potential growth.	• Lower output, sharp migration reduction in advanced economies lowers labour supply, unwinds supply gains. • Economic unbalances persist, further lowering potential growth (China, EU, etc.).	• Growth enhancing reforms lifting growth potential. • Industrial / trade policies boosting investment and activity.
CLIMATE CHANGE	• Climate change hampers growth and exacerbates stagflationary trends. • Chinese dominance in processing and supply of critical minerals; US trying to catch up.	• Further policy delays imply more adverse climate events, hampering economic dynamism.	• From zero to hero in the net zero transition: geo-engineering, globally coordinated policies.



Source: Amundi Investment Institute as of 7 November 2024.
DM: developed markets. EM: emerging markets. CB: central banks. USD: US dollar. TIPS: Treasury inflation-protected securities. FX: foreign exchange markets.

2025 Outlook

Amundi asset class views

Platform	Asset Class	Stance as of 6.11.2024	Direction of views for H1 2025	
EQUITY PLATFORM	United States	=	=	Stable
	US equal weighted	=/+	+	Improving
	Europe	=/+	=	Deteriorating
	Japan	=/+	+	Improving
	China	=	=	Stable
	Emerging markets ex China	+	=/+	Deteriorating
	India	+	+	Stable
FIXED INCOME PLATFORM	US govies	=	=	Stable
	US IG corporate	=	=/+	Improving
	US HY corporate	-	=	Improving
	EU govies (core)	=/+	=/+	Stable
	EU govies (peripherals)	=	=	Stable
	EU IG corporate	+	+	Stable
	EU HY corporate	=	=	Stable
	China govies	=	=	Stable
	EM bonds HC	=/+	+	Improving
	EM bonds LC	=	+	Improving
OTHER	Gold	=/+	=/+	Stable
	Oil	=	=	Stable
	Currencies (USD vs. G10)	=/+	=	Deteriorating

Source: Amundi Investment Institute, as of 6 November 2024.
DM: developed markets. EM: emerging markets.
Summary of views expressed at the most recent global investment committee held on 16 October 2024.

Negative view Neutral Positive view

▼ Downgrade vs. previous month
▲ Upgraded vs. previous month

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Amundi Investment Institute

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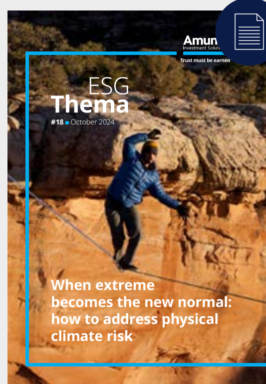
Responsible Investment



Thematic Papers

Outlook 2025

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