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Great Expectations: the PPF and PIP

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07 June 2013

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Great Expectations

The PPF and PIP

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Agenda

1. What the Government wants (and what it won't get)
2. What the PPF wants
3. What the PIP will do

Last year's messages from the Government

"There is now an urgent need to repair the decades-long degradation of our national infrastructure and to build for the future with as much confidence and ambition as the Victorians once did."

"We also want investment from British pension funds in British infrastructure – and we're now working with a dozen of the largest pension schemes specifically on that."

What the PIP will not be

- Controlled or directed by the Government
  - *Investment decisions will be made in the best interests of the PIP's owners, the pension funds*
- Guaranteed cash to fund the National Infrastructure Plan 2011
  - *The NIP offers opportunities for new assets, but see above*
- The recipient of special treatment from Government, or State Aid
  - *HM Treasury assisting infrastructure investment as a whole with £40bn UK Guarantee Scheme, but PIP will have to compete for it.*

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Principles of PPF investment strategy

- Conservative, low-risk appetite
- Liability Driven Investment strategy
- Interest & inflation rate risk reduced through investment in:
  - UK Government bonds and cash
  - Interest rate swaps
  - Inflation swaps
  - Swaptions
  - Gilt Repos
  - Gilt total return swaps (TRS)
- Diversified growth strategy
- Libor+1.8% target
- 4% risk budget

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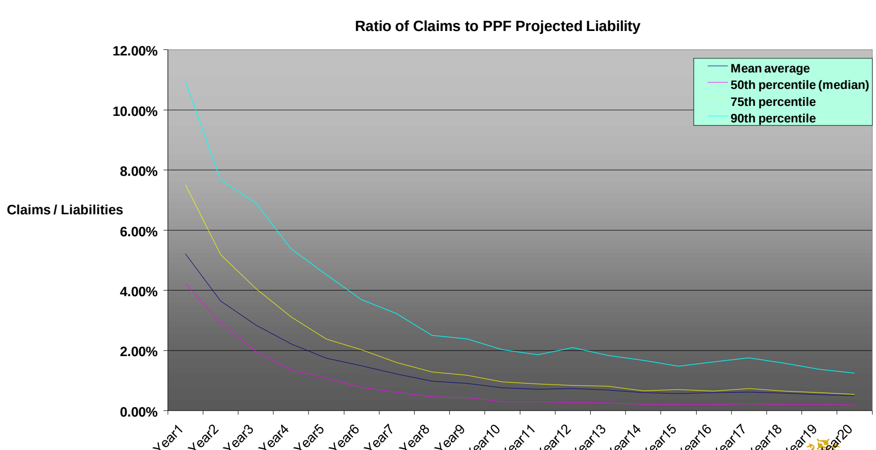
Our time horizon



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Asset Allocation

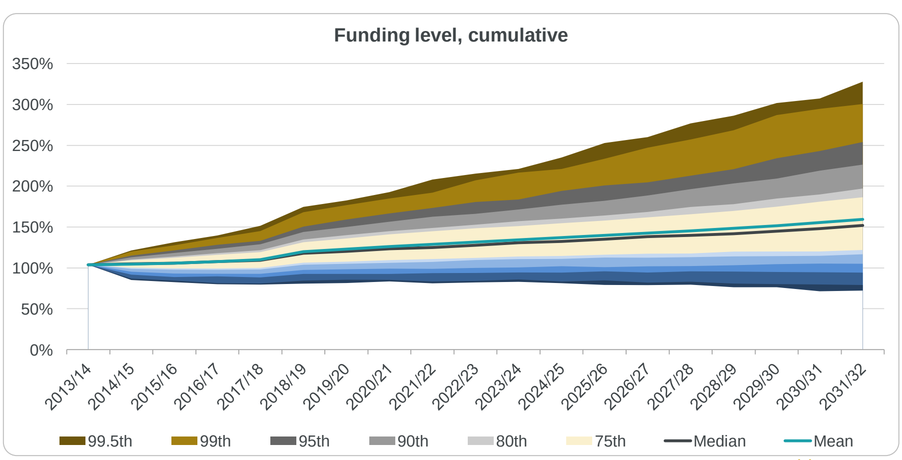
Asset Class			Allocation		
70%	Liability Hedging	LDI Collateral	£4.3bn	33%
	Global Bonds	Global Government	£2.3bn	18%
		Global Credit	£0.9bn	7%
		Absolute Return	£0.6bn	5%
		Asset Backed	£0.4bn	3%
		Emerging Markets	£0.5bn	4%
10%	Global Equity	Global Equity	£1.2bn	9%
20%	Alternatives	Real Estate	£0.7bn	6%
		Private Equity	£0.3bn	2%
		GTAA	£0.7bn	6%
		Infrastructure	**£0.1bn**	**1%**
		Alternative Credit	£0.8bn	6%

What does the PPF's current infrastructure investment seek to do?

- Predominantly return-seeking
- Diversified: mainly Europe and North America
- Variety of options
- Low risk (secured assets and sponsor)
- Target consistency & reliability of returns
- But one manager seeking to move assets on in 5-7 years

Infrastructure comes with its own risks

How do we hit the return target in the future?



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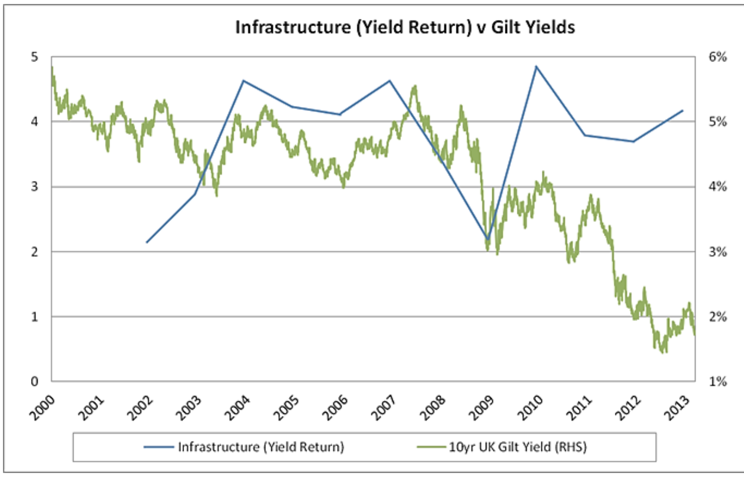
Yield comparison



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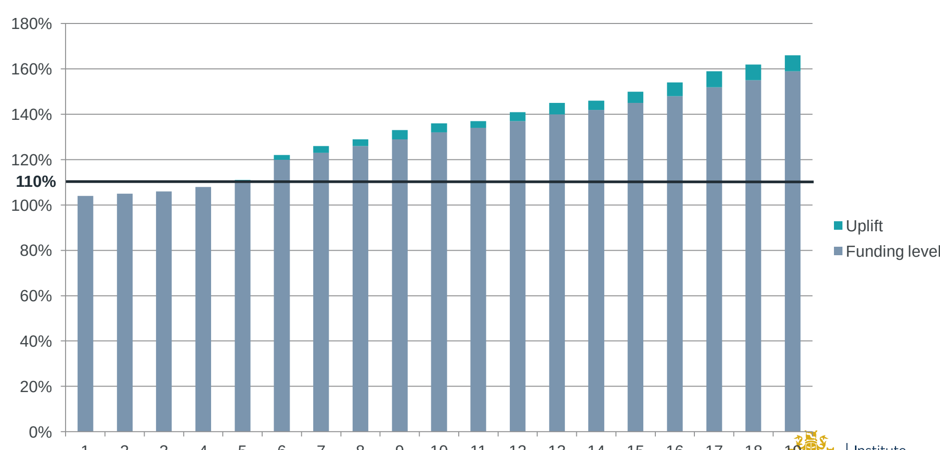
Looking for uplift



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Why does the PPF want to invest more in infrastructure?

- Long-term, inflation-linked cash flows
- Reduce dependency on hedging with derivatives
- Therefore capturing ‘illiquidity premium’
- Performance of availability-based assets (i.e. with inelastic demand) is uncorrelated with GDP or equity markets
- Infrastructure assets provide a tangible investment, and can support sustainable or socially responsible investment.

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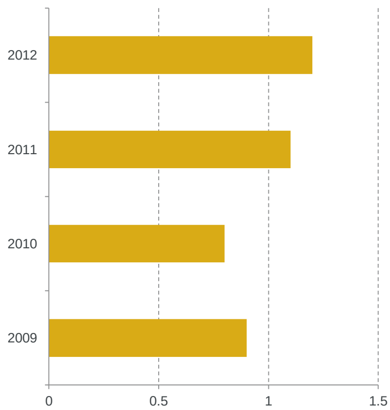
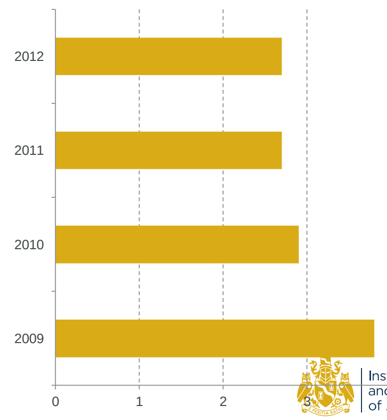
Trends for pension fund investment in infrastructure

Percentage of assets invested



Average percentage invested per fund



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Is there a problem?

Pip, dear old chap, life is made of ever so many partings welded together, as I may say, and one man's a blacksmith, and one's a whitesmith, and one's a goldsmith, and one's a coppersmith. Divisions among such must come, and must be met as they come.

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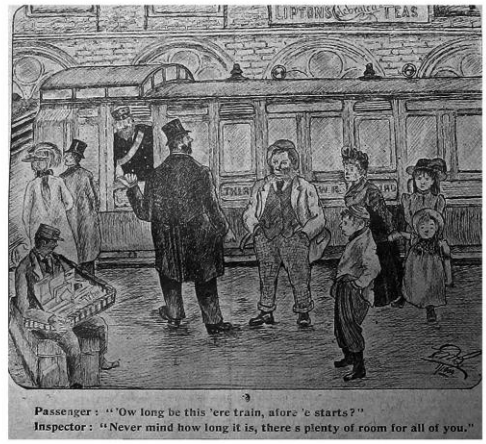
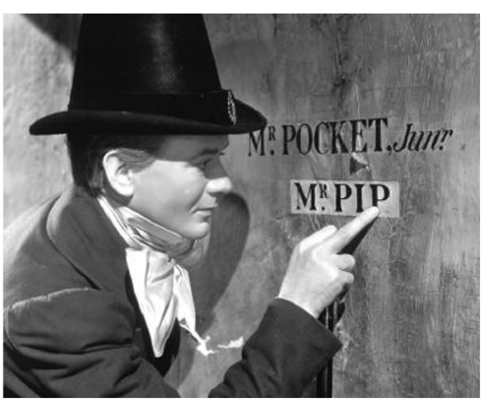
Why aren't pension funds investing?

- Lack of opportunities
- Lack of expertise
- 'Buy it, hold it, flip it'
- High fees
- Excessive leverage



What's the solution?



- For pension funds* by pension funds.
- Collective buying power
- Access to real expertise
- Long-term focus
- Fair fees
- Low leverage
- Inflation-linked returns (RPI+2-5% target)

*and other aligned investors!

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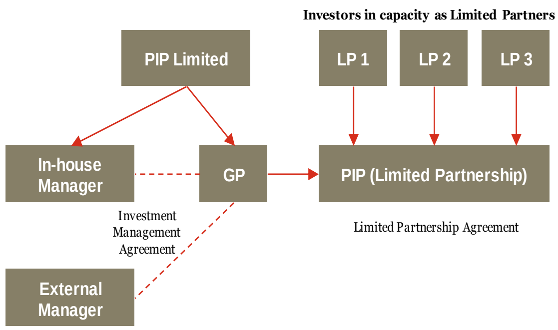
What will the PIP look like?



Founders	8-10 pension funds
Start-up cost	£100k each
Investment	£100m (‘soft’)

Target size	£2bn
Leverage	Maximum 50%
Target return	RPI+2-5%

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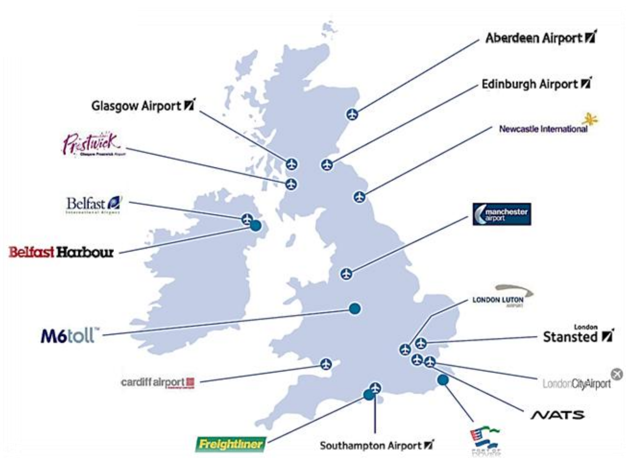
How could it invest?



Tender for operational risk, or re-think construction risk?

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Has this been done before?

Infrastructure AuM	£6.8bn (A$10bn)
Total AuM	£21.7bn (A$32bn)
Annualised return since 1994 foundation	12.3%
2011 growth	25%
Offices	London, New York, Melbourne, Sydney

How are we doing so far?

- 10 Founding Investors
- Expression of Interest exercise for investment managers closed 31 May
- Request for Proposal to follow
- Continuing discussions with Government on PF2, UK Guarantee Scheme and how pension funds can access infrastructure
- PIP launch this year

Summary

- PPF seeking to hedge (extremely illiquid) liabilities
- To date, infrastructure fund managers set-up along return-seeking, private equity lines
- On the right terms, infrastructure could be a suitable replacement for gilts
- But it's important to be aware of the complexity and risks of the asset class
- PIP will offer pension funds access to low-risk, long-term inflation-linked cash flows on fair terms

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Questions Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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