Institute and Faculty of Actuaries

Policy Priority: Future of investment
Policy Issue: Infrastructure investment

The Institute and Faculty of Actuaries (IFoA) is the chartered professional body for actuaries in the United Kingdom. Actuaries' training is business focussed, founded on quantitative risk analysis techniques and is applied across a broad range of fields. Most commonly actuaries work for insurance companies or pension funds, either as a direct employee or in firms that undertake work on a consultancy basis. Members of the profession have a statutory role in the supervision of pension funds and insurance companies.

Overview

Many institutional investors – such as pension funds and life insurers, have long term liabilities. To meet these they seek assets which provide a degree of security and a natural 'match'. Given that infrastructure assets are often integral to the effective functioning of society, they also have the potential to play a role in developing social resources in a sustainable manner. Like any investment, before deciding on the attractiveness of the returns, investors will wish to carefully weigh up the balance of return available against the risks.

This paper discusses infrastructure investment within the framework of these underlying positions, looking in turn at recent developments in infrastructure investment by pension funds, life insurers and in risk management. We believe well-chosen infrastructure investments can provide long-term, inflation-linked cash flows and are tangible assets that can support sustainable and socially responsible investment.[1]

Pension funds and investment in infrastructure

1. Investor benefits include an asset class that can preserve capital, provide a high and stable income and protect against inflation.[2]

2. In the UK, Government has identified a need for infrastructure investment – George Osborne, Chancellor of the Exchequer, stated in the 2012 Budget "*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.*"

3. The Pensions Infrastructure Platform (PIP) was the result of a Memorandum of Understanding between the Government and UK pension funds signed in November 2011. The parties agreed to develop a facility to help UK pension funds invest more in UK infrastructure assets.

4. UK pension funds have historically invested relatively small amounts in infrastructure assets. This is because most UK pension funds lack the capacity and in-house expertise to invest directly and assess risks, which could result in high fees and excessive leverage. The PIP is intended to help UK pension funds overcome these traditional difficulties by

[1] http://www.actuaries.org.uk/research-and-resources/documents/e04-pension-infrastructure-platform
[2] http://www.actuaries.org.uk/research-and-resources/documents/new-perspectives-alternative-investments

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providing a platform for UK pension funds to invest in infrastructure. [3] As of September 2014, PIP has nearly £300m worth of investment committed and over £200m of this is already funding 41 separate infrastructure assets.[4]

Appropriate infrastructure assets can provide pension funds with attractive risk / return profiles, liability-matching cash flows and diversification benefits. The IFoA also welcomes infrastructure investment that is sustainable and socially responsible.

Life insurance and investment in infrastructure

5. Insurers have a role in infrastructure investment as long-term investors. The Treasury's 2013 document 'The UK insurance growth action plan' announced "*Aviva, Friends Life, Legal & General, Prudential, Scottish Widows, and Standard Life will work alongside partners with the aim of delivering at least £25 billion of investment in UK infrastructure in the next five years.*"

6. This announcement followed negotiations on the matching adjustment under Solvency II, which helps insurers to invest in social infrastructure projects such as power stations, housing and hospitals as it actively promotes long-term investment in growth and infrastructure.[5]

7. Debt financing of infrastructure appears to be an appropriate fit for annuities as it is long-term (12y+ duration). Inexpensive debt financing levels mean infrastructure equity investments may complement a with-profits portfolio of listed equity. [6]

8. Insurers are already actively investing in infrastructure projects:
    - Aviva is funding the development of Inverness College campus;
    - Legal & General has invested in several student accommodation schemes at UK universities;
    - M&G (Prudential) is providing funding for Alder Hey Children's Hospital in Merseyside; and
    - Friends Life has agreed a loan facility with Drax Group plc underpinned by the UK Guarantee scheme.[7]

Infrastructure investment proceeds can match life insurers' liabilities – for example debt financing of infrastructure could be an appropriate fit for annuities, and infrastructure equity investment may complement a with-profits portfolio of listed equity.

A risk management approach to infrastructure investment

9. Members of the IFoA, in collaboration with the Institute for Civil Engineers, have published the third edition of Risk Analysis and Management for Projects (RAMP). RAMP provides a framework for analysing and managing project risk, placing emphasis on strategic and

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[3] http://www.parliament.uk/briefing-papers/SN06594/infrastructure-policy

[4] http://www.napf.co.uk/PressCentre/NAPFbuzz/0604-Mike-Weston-appointed-Chief-Executive-of-Pensions-Infrastructure-Platform-Ltd.aspx

[5] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263148/the_UK_insurance_growth_action_plan.pdf

[6] http://www.actuaries.org.uk/research-and-resources/documents/c4-infrastructure-debt-and-equity-investments-uk-insurers

[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263148/the_UK_insurance_growth_action_plan.pdf

financial aspects, with the aim of promoting better decision-making and greater likelihood of success. This framework is already used by Crossrail – the company responsible for building a new £15billion railway in London - as its risk-management process.

10. This approach encompasses all factors that influence project success – if the boundaries are too narrow, for example if long-term impacts are excluded, it may result in poor decisions and poor projects. Specifically for infrastructure projects RAMP highlights the need to include social and environmental risks as these factors could have long-term impacts. Social risks might include the quality of life for individuals and communities and environmental risks include both impacts of the project on the environment such as pollution and risks resulting from the environment such as flooding. This is important for pension funds and insurers that are seeking long-term investments in infrastructure.[8] [9]

A risk management approach to infrastructure investment facilitates a balanced view of the risks investors might face when considering expected returns from potential investments.

Further information:

Institution of Civil Engineers; Institute and Faculty of Actuaries, Lewin, C.G. (ed) (2014) *RAMP: Risk analysis and management for projects: A strategic framework for managing project risk and its financial implications.* London: Thomas Telford

EIOPA starts work on infrastructure investments by insurers - press release published 4/2/2015, available at - https://eiopa.europa.eu/Pages/News/EIOPA-starts-working-on-infrastructure-investments.aspx

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[8] Institution of Civil Engineers; Institute and Faculty of Actuaries, Lewin, C.G. (ed) (2014) *RAMP: Risk analysis and management for projects: A strategic framework for managing project risk and its financial implications.* London: Thomas Telford

[9] The author, Chris Lewin, chairs the IFoA Working Party 'Risks and returns in infrastructure projects'. It will present a paper and a session at the Risk and Investment Conference in June, which will include the profile of risk categories at a strategic level. In July 2013, in collaboration with UCL, Chris submitted a paper to the Treasury, looking at the risks and rewards of institutional investment in infrastructure.