PENSION INSURANCE CORPORATION

Response by Pension Insurance Corporation plc to the National Infrastructure Commission call for evidence

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Pension Insurance Corporation does not regard any of the information in this document as confidential.

Introduction

Pension Insurance Corporation plc (PIC) provides tailored pension insurance buyouts and buy-ins to the trustees and sponsors of UK defined benefit pension funds.

Clients include FTSE 100 companies, multinationals and the public sector. At year-end 2014 PIC had a portfolio of £13 billion and approximately 30% of this, or about £4 billion, was invested in infrastructure debt. PIC now has more than £16 billion in assets. The vast majority of the balance is invested in investment grade corporate bonds, UK Government debt and cash.

PIC is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and Prudential Regulation Authority (FRN 454345).

For further information please visit: www.pensioncorporation.com

Our interest in this consultation

As a specialist pension insurer with liabilities analogous to those of a defined benefit pension fund, we look to buy and hold assets which provide long-term, stable cash flows which match the underlying liabilities of the pension schemes we insure. The regulatory environment is driving demand for these cash-flows to come in the form of investment grade debt. Our portfolio is therefore principally invested in assets such as UK government debt, corporate bonds and cash.

One of the key facets of our portfolio is the very long-term, non-callable nature of the liabilities insured by PIC. This means we can invest in illiquid assets which are, by definition, hard to sell. A good example of this is infrastructure debt.

Infrastructure debt can offer investment grade, inflation-linked, long-term cash flows to match liabilities. It offers high recovery rates even in default, above similarly rated corporate bonds. An increase in availability of this type of investment would allow more pension liabilities to be matched. Given there are around £2 trillion of corporate defined benefit pension liabilities in the UK, there will be substantial demand for assets.

However, the UK is suffering from a major "infrastructure gap", in that there are huge infrastructure demands within the economy and increasingly interested and cash-rich institutional investors, such as PIC, yet a dearth of suitable investments, notwithstanding the plans for the 'Northern Powerhouse'.

A more stable and strategic approach to infrastructure planning and delivery by government would go a long way to helping grow GDP and produce secure investments at attractive yields for pension funds, insurance companies and other UK institutional investors.

We welcome the creation of the National Infrastructure Commission (NIC) as a step towards improving the investment environment and welcome this opportunity to contribute to the public discussion about infrastructure.

We believe a key objective of the NIC should be to build and then maintain a healthier ongoing dialogue between infrastructure planners and the UK funding markets. In our view there has been a strained relationship in the past, which is now improving. As institutional investors become an increasingly important part of the funding equation, there is a real opportunity now for a more collaborative approach.

As natural lenders we want government to understand what is important for us and to above all ensure consistency in its approach. The key aspect for long-term investors is long-term certainty and visibility of the cash-flows.

Most infrastructure projects are long term in nature, so the governance needs to reflect this.

This in contrast to short term political cycle so the governance needs to be de-politicised as far as possible, something we considered as part of a detailed study of UK infrastructure we undertook with Llewellyn Consulting in 2013.[1]

This de-politicisation of the process has been done before with the removal of interest rate setting to the Bank of England.

[1] https://www.pensioncorporation.com/news-media/news/pension-insurance-corporation-launches-white

The NIC is able to take a longer view and create greater certainty for all interested stakeholders – consumers, construction industry, other industry participants such as facilities management companies, local government and the financing market.

This could be a win-win situation for the UK, a serial under-investor in infrastructure. At a time when the need for infrastructure investment has never been greater and the desire of institutional investors is correspondingly strong, it is time to ensure that these pools of money can be put to work rebuilding Britain.

The role of governmental bodies must be to facilitate the development of private capital funding, not replace it except when a project is not viable without governmental support or subsidised funding. They need to act as facilitators of projects and they can use guarantees and involve supranational bodies in the financing.

As noted, there is a very large demand for long dated high quality assets from UK institutions. Yet there is also a real ongoing risk of crowding out by supranational issuers such as European Investment Bank, who are able to offer cheaper debt.

An excellent example of successful facilitation by the government was Mersey Bridge, where the deal only obtained finance because of the Government's guarantee.

We confine our comments only to those areas in which we have a particular interest and expertise, namely those that relate to the governance and financing of infrastructure projects.

PIC is a consistent innovator in the field of infrastructure investment

- PIC invested in the first-ever UK Solar Bond financing in November 2012.
- PIC invested in Salford Pendleton Social Housing PFI debt which had project bond credit enhancement via mezzanine financing – this was before the European Investment Bank (EIB) had placed their first deal within the UK with a similar financial structure.
- PIC adopted a deferred funding model, where funding is being drawn down over three years in line with the construction profile, with its North Tyne social housing PFI transaction.
- PIC lent £70 million to the Church of England Pensions Board, which operates the Church's retired-housing scheme, in a new source of long-term financing for the Church housing scheme. The bond is the first ever Sterling issue with the coupon but not the principal linked to CPI and represents a step forward in the CPI linked bond market.
- PIC invested £75 million in debt issued by Virgin Atlantic Airways, secured on its portfolio of landing slots at Heathrow, the first time that this type of transaction has been completed.
- PIC has invested more than £1 billion in bilateral infrastructure transactions in sectors including utilities, transport, renewables, social housing, PFI and student accommodation.
- PIC has been involved in loan and bond funding for a number of primary deals, including investing in over £400m of transactions that have significant greenfield or construction risk.
- PIC has been involved in funding consortia for transactions working alongside banks, other insurance companies and other leading counterparties active within infrastructure in the UK.

- PIC provided around £150 million of funding as the key investor for two PFI bonds in Greater Manchester providing funding for Salford City Council to begin regenerating more than 1200 homes in the city and then funding for Manchester City Council to begin regenerating more than 1100 homes in the Brunswick area of the city.
- PIC is invested in long-dated fixed, floating and inflation-linked debt and works closely with borrowers to offer their preferred funding solution.

Connecting northern cities

What form of governance would most effectively deliver transformative infrastructure in the north, how should this be funded and by whom, including appropriate local contributions?

GOVERNANCE

The importance of governance

From an investor perspective, strong governance that brings long-term certainty and visibility of the cash flows is critically important, as it helps ensure:

- investment programmes have public support, therefore minimising the risk of policy reversal or abandonment;
- taxpayers receive value for money, underpinning the fiscal credibility of investment programmes;
- private investors have sufficient confidence in project management to provide early stage equity finance;
- where applicable, infrastructure assets are economically viable such that private investors can purchase bonds at project maturity;
- where there are guarantees or tariff regimes they will not be altered.

Key investor infrastructure investment governance issues

Certainty is important because investing in infrastructure is a complex area. This complexity is a significant barrier for many pension funds. It takes time and effort to build up the expertise and partnerships necessary to successfully invest in this area. Investors need to have the resources and ability to analyse:

- Credit issues
- Structure deals
- Price deals

They need to be confident that the time they spend looking at an opportunity and the effort expended in acquiring skills and resources to analyse the deal will be worth it. A lack of certainty in the process can undermine the desire of certain types of institutional investor, in particular pension schemes, to invest in infrastructure.

Championing infrastructure programmes

Agreed national infrastructure priorities could be championed more aggressively, perhaps using the 2012 London Olympics as a model for successful delivery. That was a large, complex, and diverse project, that involved numerous layers of planning and the engagement of all levels of government, and which at its completion generated numerous saleable assets.

In the case of the Northern Powerhouse, a similar delivery authority could be created. Due to the nature of the initiative, and the devolution of power to local level, city and local authorities would have to be formally recognised in the development and implementation of any plans.

Clear long-term plans with political buy-in are an absolute necessity

A delivery authority is of little benefit if there is no clarity about what precisely it is supposed to be delivering. This underlines the importance of a coherent infrastructure plan which is both technically sound and based on a rational assessment of present and future needs. We feel that the National Infrastructure Plan fell short of providing this, but the NIC's National Infrastructure Strategy could address these shortcomings, although we note that five years is still only one political cycle.

Features which we think are essential in governance structures at regional or national level are as follows:

- co-ordinated across different departments and levels of government (including local and city governments);
- devoid of frequent policy reversal and prevarication over key decisions;
- supported by regulatory stability (especially in relatively regulation heavy sectors such as energy and utilities); and
- dovetailed with the ability of construction firms to supply the necessary resources to do the job.

The role of the National Infrastructure Commission in governance

We welcome the creation of a National Infrastructure Commission and this consultation. The NIC has an opportunity to bring the long-term thinking and clarity that appears to have been lacking in UK infrastructure policy its National Infrastructure Strategies. The creation of a predictable project pipeline with delivery timelines would significantly enhance the infrastructure investment environment in the UK – including, crucially, in the North and bring strategic, long-term benefit to the UK economy.

London’s transport infrastructure

What are the options for the funding, financing and delivery of large-scale transport infrastructure improvements in London, including Crossrail 2? What innovative funding mechanisms could be considered to support delivery of key schemes?

Is funding for London infrastructure projects a special case in the UK?

As an institutional investor, our views about the funding of large projects in London are similar to those relating to the funding of infrastructure in the North. However, the scale of the London economy and its global profile - along with greater devolved powers - does give London more scope to direct its own infrastructure priorities and potentially to fund them than other regions.

Initiatives such as the London 2050 strategy include practical steps to help make infrastructure planning and delivery easier through tools such as the Infrastructure Mapping Application. This shows the role that local and regional government can have as an enabler of investment as well as a policy maker and funder.

We believe that the NIC should have oversight of, and offer strategic guidance on, all major infrastructure projects including those in London – particularly since certain London infrastructure projects are of strategic national importance. Crucially, this will require partnership between the GLA, London Boroughs and the NIC. It is important that local government has a strong say in infrastructure projects, but equally projects must fit within a coherent national framework to avoid duplication and to ensure road, air, rail and sea transport are integrated in a way that serves the national economy.

We don’t offer views on the how costs to taxpayers should be distributed as this is a political question – though there is logic to the view that those that benefit the most from improvements to infrastructure should bear a greater proportion of the costs of its provision. For this reason further consideration should be given to what fiscal and policymaking powers can be devolved to London authorities.