Guest Editorial

Investing in Britain: The Pension Protection Fund in the United Kingdom

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Four years on from the banking crash, the world economy is still in intensive care. Many people expected the economy to have turned the corner by now, but instead pundits are faced with a seemingly intractable set of indicators. An acute lack of demand is being aggravated by a virtual lending drought, which makes it very difficult for employers to expand their businesses and take on more staff. This leaves the economy stuck in the slow lane. As the banks are still licking their wounds, and lending to the real economy has slowed to a trickle, the UK government and the Bank of England have tried to step into the void, so far with only limited success.

Various rounds of quantitative easing by the Bank of England have now been followed by a ‘funding for lending’ scheme from the Government, which has been specifically designed to remove the blood clot that is preventing credit from reaching those parts of the economy that are in dire need of investment. Hopefully it will work. The fear that certain parts of manufacturing industry will simply turn into gangrenous limbs in the prolonged absence of outside credit and finance has become a real worry in the upper echelons of power and the corridors of Whitehall. It seems as if the air is simply continuing to escape from the economic tyre that was punctured so savagely in 2008/2009.

The economy requires new and imaginative ways of financing. Initiatives that would have been hard to imagine in the days before the credit crunch are now seen to hold the key to getting the economy going again. Recently, the Government publicly floated the idea of

tapping the resources of pension schemes to help boost the economy. The idea would be for pension schemes to divert some of their investments into public infrastructure projects instead of sticking to the more traditional asset classes such as bonds and shares. This would have the advantage of diversifying the investment strategies of pension schemes, as well as putting pension money to good use in the national interest by helping to finance projects that will strengthen the UK’s economic foundations as well as assist in creating jobs.

Such a strategy is already being pursued by the Pension Protection Fund (PPF) in the United Kingdom. It is not as if the PPF has simply seized on some clever new wheeze. The option of using infrastructure projects as an alternative investment has been available as part of the PPF’s statement of investment principles for a few years now. But unsurprisingly, given the economy’s anaemic performance, this has recently attracted attention as one way in which pension resources can be applied to obtain long-term returns while spurring on the recovery at the same time.

The PPF opened its doors in 2005. Its job is simple: to rescue underfunded pension schemes whose sponsoring employer(s) have gone bust. The PPF’s procedure reflects this. Where an employer becomes insolvent, the PPF conducts an assessment of schemes that are eligible to be saved: where there is no realistic chance of another employer taking over the role of scheme sponsor, the PPF will normally take the ‘failed’ scheme under its wing. All the remaining assets and liabilities of that scheme then transfer to the PPF and the affected employees and pensioners

are effectively turned into scheme members of the PPF. Since 2005, the PPF has grown in size due to the large number of underfunded schemes that have been driven into its arms.

According to a recent report in *The Times* (1 September 2012), the PPF now sits on assets of about £12 billion and pays pension benefits to almost 143 000 members hailing from about 480 pension schemes. If the recession continues and more pension schemes go under, this could increase to as much as £80 billion by 2030. If this were to happen, the PPF would have become the United Kingdom's single biggest pension scheme, overtaking the massive BT Pension Scheme (which has assets of about £37.8 billion). The PPF would have turned into a veritable behemoth, which is not surprising when you consider the fact that it has had to swallow the pension schemes of some big household names such as Woolworths, Allied Carpets, MG Rover and Reader's Digest. As the process of remorseless deleveraging continues to reshape Western economies, more big names might join their numbers in future.

The PPF is therefore sitting on a mountain of cash. Leaving that cash to fructify in the coffers of the PPF would be one option, but recently the PPF decided to broaden its investment strategy. Although it does put money into the standard investment options for pension schemes (the usual mix of bonds and equities), it is now also investing in projects such as road, rail and hospitals. Currently, the PPF only invests about 5 per cent of its assets (about £600 million) in these infrastructure projects, although this is set to rise gradually over time.

This is good news and seems to be the apposite response to the Government's call on pension schemes to consider investing in

the 'real' UK economy. Where such investment would previously have come mainly from the banks, other players within the economy are now stepping into the breach. If it had not been for the emergency facing the economy, none of this might ever have happened. But surely it is only sensible for pension money to be used as a national asset in helping to revive the national economy? As long as the PPF's treasure is not being applied in an imprudent way, there seems little reason to quibble with its decision.

Investing in infrastructure is a different proposition from putting money into bonds or equities. For a start, the rate of return is likely to be lower and in any event (unlike shares) not designed to produce results in the short term. There is also a psychological factor to consider. The only investments other than bonds and equities that trustees of pension schemes are likely to have experience of are investments in real estate. It would therefore be quite a leap for most pension schemes to go the whole hog and switch to investing in large infrastructure projects with which they are unfamiliar. Certain pension schemes are probably too small to be able to muster an investment big enough to make this worthwhile. But the PPF does seem to be blazing a trail where others will follow.

Pension schemes in the United Kingdom will no doubt examine the option of investing in infrastructure projects with greater interest in the future. As everyone knows, the economy needs all the help it can get at the moment. If pension schemes can succeed in mining a new seam of investment opportunities while helping industry to create jobs in the process, everyone will win.

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