

NAPF Investment Conference 2008

Arno Kitts, Conference Chairman

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Good afternoon ladies and gentlemen, and welcome to the 2008 NAPF Investment Conference.

Now, before we get started, I know we're getting hooked on these, especially my Fund Management colleagues, but please let's switch them off now - there will be opportunities for gadget fixes during breaks. Thank you.

I have to say, it is really good to see so many of you here, and thank you all for coming to what I believe will be a challenging and rewarding conference.

Now, I don't know - how many of you have had to stand in a queue today? At the train station? At the airport? At Starbucks? Even at the escalators to come up into the hall here.

How many of you like queuing? I hate queues. I get frustrated at the complete waste of time and I get irritable ... and that's on a good day. I do accept that I have to queue for some things - like getting into Murrayfield to watch England thrash Scotland at rugby on Saturday ... We'll see! ... But I should NEVER have to queue for something that is mine already and nor should anyone else.

And yet, that is what thousands chose to do last summer. They were scared of losing money they thought was safe.

So why were they queuing like this?

Well, I could tell you in industry speak - the progressive development of global financial markets and the complexity of inter-related dealings by global financial institutions over the last 10 years has enabled risks to be sliced and diced in multi-layered packages based on portfolios of assets including mortgages.

But to them, simply put, their money may have been lent for dodgy mortgages and they got really scared they might not get it back.

Who would have thought that US sub-prime lending would have had such an impact globally, including the first run on a UK bank for over a hundred years. Who would have thought it would develop into the black cloud hanging over us now?

Banking business models have created vehicles that put a lot at risk.

I think it is sadly ironic, because:

- On one hand, accountants and regulators have been all over UK pension funds to have their assets and liabilities marked to market on corporate sponsor balance sheets, and now there is talk of tightening the screws further with recent ASB proposals, and then there is EU Solvency 2 on the horizon.
- And yet, on the other hand, liabilities much greater than those of our UK pension funds have been ballooning in structured products valued on a mark to model basis, infecting and inflating the balance sheets of many big banks, and potentially stagnating those balance sheets until the current problems sort themselves.

And the effects continue:

- The credit market is sucking in air through its teeth.
- Equities are on a roller-coaster
- And now the economy is being impacted, with talk not of 'if' there will be a recession, but how deep it will be and how long will it last.

So, what does all this mean for workplace pensions - do we head for the hills?

No! ... the key message here is ... don't panic!

Why?

Because pension funds are long-term investors. Trustees set their investment strategies in accordance with the sponsor covenant and long-term liabilities, and are not overly worried by short-term market movements.

So, don't panic! But, the message is don't be complacent either.

At the close of last year's conference I talked about three investment themes: good governance; measuring and managing risk; and evaluating opportunities. I believe these are the critical success factors at the heart of good pension fund investing.

Successfully done, that's what "investing today to secure tomorrow" – the theme of this year's conference – is all about. And it's what we've been focusing on in the NAPF over the last year.

In this introduction, I can't hope to cover all the important developments since last year, nor do justice to the effort and results achieved by the NAPF, its Executive and all those of you who volunteer to contribute as Investment Council members, or otherwise. So, we prepared a summary of the key developments and areas of NAPF activity and a copy is in your delegate pack.

However, of the many developments, I will highlight just two:

First, there has been a power shift, with trustees and The Pension Regulator flexing their muscles. Now, it is only right that pension members' interests are protected and their reasonable expectations fulfilled. However, it is also true that decisions must be made objectively, seeking to understand the strategic intent of acquirers, including private equity firms, without fearing the worst and jumping to conclusions. With the power that has been vested in trustees and The Pensions Regulator comes responsibility to wield that power carefully.

Second, the pension consolidation and insurance predictions made on this stage last year appear to have been justified, with almost seven billion in total now. This

is going to be a market that continues to develop and innovate. NAPF will continue to monitor developments, and we will continue to inform and guide trustees to be confident to deal with the issues.

In terms of NAPF activity, it has been a particularly busy year.

[Slide - Investment Council Activity]

Most notably, the review of Myners Principles is on course to be a great success. Credit for this is due to Joanne Segars, Nigel Peaple and Julian Le Fanu in particular. The inclusive approach adopted has resulted in a broad consensus of support for the conclusions and recommendations. These recommendations provide a new framework of high level Principles, supported by guidance and tools to help trustees. We believe that this will facilitate continual improvement in investment decision making, and consequently results. Our task was made easier due to the significant improvement in pension fund governance over the last several years - the result of trustees' hard work and dedication. Well done!

Second, with a longer-term perspective, crucial groundwork has been done on Personal Accounts, which will have a significant impact on pension provision over the next few years. We have been supportive of Personal Accounts, but we recognise that there are risks that employers might "level down" and that they will be subtly nibble away at existing workplace pension provision. NAPF is lobbying hard to ensure Personal Accounts impose minimal additional cost and administrative burden.

Now, back to pension investments, and our core themes: governance, measuring and managing risk, and evaluating opportunities ...

- Investing today, securing tomorrow.

If you look at the key developments, you can see that pension funds deserve recognition for moving in the right direction - they are better funded, take less

strategic risks, and have more diversified investments than a year ago. Well done again!

Investment strategies are significantly more sophisticated than those of just a few years ago, and those of a few years ago were more sophisticated than those of a decade ago, and so on.

But, if we step back and look at pension investments in perspective, should we be feeling comfortable with our progress, or should we be feeling a sense of urgency to make further progress?

In short, have we gone far enough fast enough?

UK Pension Funds have over £1 trillion invested to pay pensions.

Let's get a sense of urgency by looking at this trillion slightly differently – as it was all in just one fund. After all, that would not be so different from the way some Sovereign Wealth Funds work. Imagine one of us was selected to be the CIO of our £1 trillion pension investment fund. What would you do?

Let me tell you where I would begin.

First of all I would ask – is it smartly invested now, or do we need to make changes?

- Well, if it is smartly invested why am I here? Why are you here? So maybe we can presume to consider some changes.

And, if we are to consider some changes, where should we start?

Let's start with Strategic Risk:

- We could ask for more money from the sponsors - we could get them to commit to more funding through negotiations.
- But, that is not going to be so easy, so maybe we should not expect too much.

We could change investment strategy.

If we look at where we are today this is how it is split up.

Now, there is no single answer here, but let's just be open-minded.

There is quite a lot in equities, isn't there?

- We've got over a third in UK Equities, when these make up just 10% of the world market.
- In fact, we have four times as much in UK as US equities, which make up 50% of the world market.
- As CIO of our £1 trillion fund, I might not be comfortable with that.
- It is certainly less than it was. But, is that diversity? Is that smart?
- Maybe we need to look at that and rethink.

What about Bonds and Cash?

- Certainly, these are a safer match for our fixed and inflation-linked liabilities, and we have put more there.
- But again, is that good or not so good? Should we be more cautious or not?
- With yields of less than 5% and real yields of a lot less, it is not going to be easy to pay pensions with bonds. These bonds might exacerbate a big funding problem in the long run.
- So maybe we need to be more adventurous, to make sure we can pay pensions.

And that brings us neatly to alternatives.

- There is less than 10% in alternatives.
- I think I should be putting more here because it diversifies the asset much more, and I ought to be getting good returns.
- Am I being brave enough to identify and invest in new asset classes before the rest of the crowd - agricultural land; or even film rights.
- If I could wean myself off my obsession with liquidity, I would be harvesting the illiquidity premium, which there is time to do since some of these pensions are not going to be paid for many years.

- But, am I just buying the same alternatives as everyone else, and at inflated bubble prices? Are commodities an example? Might I regret this later? So, I have to evaluate these opportunities carefully to ensure that I am making sound decisions.

And let's not forget that this might be OK with a £1 trillion fund, but smaller pension funds might not have enough governance resources, so to do all this we would have to consolidate funds.

Hey ... I can dream ... and you can dream of running a trillion fund. But, it does raise questions that we need to address.

We have to think more clearly, cleverly, and creatively about governance, about measuring and managing risk and about evaluating opportunities. We must do this now, if we want to ensure that investing today will be securing tomorrow.

That is why we have developed a challenging programme for you, which will make us ask questions, debate options and look for solutions. While continuing to cover traditional and new topics, I am particularly pleased that the programme includes more on strategy and is more international. We've got sessions ranging from cautious fiduciary management services to racy alternative asset classes. So there's something for everyone.

These questions also go to the heart of a new NAPF investment competition - a competition all about the implementation of innovative and successful investment strategies - the issues at the core of this conference and of our Investment Council work.

Taking account of covenant, liabilities, governance capability, and resources, we want

- DB funds to tell us how they are developing their investment strategies; and,

- DC arrangements to tell us how they are designing their default investment options.

The competition is open to all NAPF pension fund members. It will run for six months and the two winners – one DB and one DC – will be selected by our panel of expert judges and will be announced at the NAPF Annual Conference & Exhibition in October.

The competition is being co-sponsored by FTfm, which will provide coverage and profile the winning entries, and my own firm – Henderson Global Investors - will provide donations to Macmillan Cancer Relief for entries and provide prizes for the winners.

I encourage funds – DB and DC, large and small – to enter the competition. There are entry forms in your packs, and you can pick up forms from the NAPF stand. Good luck!

Before that, you can have a bit of fun with our “guess the FTSE” competition. Here’s what the FTSE 100 index was at 12 noon today. We want you to guess what the index will be at 12 noon on Friday. We have an iPod touch for the winner and an iPod nano for the runner up. Again, forms are in your packs, or visit the NAPF stand to enter.

Also, in your packs, please do complete the registration card for the NAPF Annual Conference & Exhibition, in October.

Let’s get on then. But, before I introduce our first guest speaker, I need to cover three housekeeping points:

First – We are not expecting a fire alarm test so if you do hear the alarm, it is the real deal. You will hear a continuous alarm followed by a recorded message to start the evacuation procedure. Please stay in your seats for further instruction. If we do need to evacuate, ushers will guide us out of the building.

Second - If you have a ticket for the dinner tonight but cannot attend, please return your ticket to a member of the conference staff in the registration area. Whether you attend the dinner or not, if you've got the stamina, don't forget the after-dinner party at the Balmoral Hotel, once again kindly sponsored by Russell Investments.

Third and finally - It's really important that we know what you think of the conference and what would make it even better next year, so please do complete the feedback form in your pack. We can only take account of your views if we know what you think. The providers of the first 50 forms will get M&S £10 vouchers.

Enough from me. It now gives me very great pleasure to introduce our first guest speaker - Lord Eddie George, former governor of the Bank of England, and previously with the International Monetary Fund. During his ten years of governorship, the Bank was given independence for setting UK interest rates. I am sure that we will hear some interesting perspectives on markets and the economy. However, I should warn you that he will not talk about nor answer questions on Northern Rock. Ladies, and gentlemen, please welcome - Lord Eddie George.