Confederation of International Constructor's Association

Update on Investment Perspective on Long Term Financing of Infrastructure

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Environment improving for long term investors in infrastructure – reducing cost and increasing potential availability of funds

Determination imminent on changes to Solvency II regime (relating to insurers) for infrastructure

- EU rule change re insurers proposed - Jan 1 2016 - re infra investments
- Relaxes key capital charges (insurers required to hold less capital relating to infra investments > more liquidity and lower costs)
- Follows/improves on EIOPA (European Insurance and Occupational Pensions Authority) recommendations to EU
- Supports EU policy objective of €315bn new infra investment by 2017
- Recommendations shaped/supported by infra industry, EDHEC - LTIIA
- Key concepts relating to infrastructure considered - number of principles established for future use
- What is in, what is out – hierarchy of attractive investment supports PPP

Key concept of ‘infrastructure assets’ defined allows specific ringfencing of assets and appropriate capital treatment

Proposed legislation introduces concept of “qualifying infrastructure investments” for equity/debt – assets need to fulfil various criteria

- Infrastructure assets are defined as: “physical structures of facilities, systems and networks that provide or support essential public services” – *important not only for Solvency II but more generally as the key long term definition of infrastructure assets for investors*

- Investments to be made into “infrastructure project entities” (IPE) ie SPVs
- IPE must receive ‘predictable’ cash flows ie availability based (or regulated payment from a large number of users)
- Payments may come from a large number of users or ultimate purchaser is rated BBB or EU institution, not yet local authorities
- The underlying asset must benefit from a contractual framework, including cover for termination and sufficient reserves in the IPE

Where criteria are satisfied, the asset receives a more favourable capital charge, ie less capital is held

Key elements relating to infrastructure debt

- Impact of new charges on qualifying investments – BBB rated debt with maturity of 3 years now have 5% capital charge rather than 7.5% capital charge, together with other beneficial results for insurers

Other criteria:

- Bonds or loans must have a minimum credit quality of BBB
- Insurer must demonstrate that the debt can be held to maturity
- Investors must have security over the contracts and assets
- Equity in the SPVs must be pledged to the debt providers, with step in rights

Where criteria are satisfied, the asset receives a more favourable capital charge, ie less capital is held

Key elements relating to infrastructure equity

- Impact on qualifying investments – IPE not related to the insurer capital charge – 30% - listed equity has a charge of 39% and unlisted equity charge of 49% - IPE related to the insurer capital charge 22% - this makes it significantly more likely that investors will put equity into infrastructure

Other criteria for 30% charge:

- Infrastructure assets and the IPE must be located in the EEA or OECD
- Equity investors must
  - History of overseeing infrastructure
  - Low risks of default
  - Incentivised to protect investor interests

Impacts of change and other issues

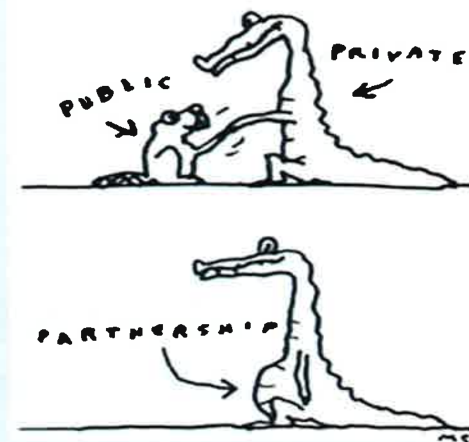
Results

- Insurers are more likely to make infra investments, focussing on clear parameters they will be able to shape and clarify infra portfolio
- Will provide further liquidity and competition to financing infrastructure
- Other key elements – it shows that infra industry pressure can influence regulators to ensure more favourable conditions for the realisation of more infrastructure
- Provides basis for developing the asset class as definition developed and whole investment class is created
- Allows precedence for any further regulatory changes eg IORP (The **IORP** Directive[1] is the European prudential framework for Institutions for Occupational Retirement Provision (**IORPs**) or pension funds.)
- Gives heart in respect of other regulatory issues such as ESA 2010 that change can be positively viewed

ESA2010 and impact on infrastructure development

New regulatory concern

ESA 2010 replaced ESA95, the regulation from Eurostat relating to national account statistics re on/off balance sheet debt for EU nations



- ESA2010 rules say that projects are public sector if the 'majority' of risks and rewards revert rather go to private sector
- Potential limitation, if on balance sheet, to national spending powers, whilst issue is worked on - projects are delayed or stalled
- Political dimension: under PPPs, strong feeling that sharing upside with private sector essential to balance outcomes eg refi gains
- A solution: separate revenue/capital for infrastructure share of budgets

Impacts for CICA

- Changes in regulation need to attract engagement from the private sector
- The infrastructure debate is not well understood, and there is still a strong bias for public sector development despite the fiscal constraints many countries labour under in the EU
- Strong availability of private money, potential substantial infrastructure needs but linking apparatus not effective at the moment
- Issues are worth focussing on and responding to, so that not only for investors but also contractors there is a strong robust pipeline of well structured projects