## Insurance and infrastructure investments: a happy marriage?

**Carlos Montalvo Rebuelta** - Executive Director, **European Insurance and Occupational Pensions Authority (EIOPA)**

Infrastructure investments are generally long-term. The revenues of infrastructure projects can be less volatile as they provide in many cases essential services, have high barriers to entry or benefit from some kind of guarantee by a governmental body. They are also sometimes linked to inflation.

The long term nature of their liabilities allows insurers to have a longer time horizon than many other institutional investors. Many retirement products promise fixed payments. It is therefore natural to look to insurers as a potential source of infrastructure financing. They could in turn benefit by diversifying their holdings and earning illiquidity premia.

Regulators cannot be oblivious of the economic challenges Europe is facing. But the main purpose of regulatory requirements is to protect policyholders. Regulatory capital provides a margin of safety. Any specific treatment of infrastructure investments must therefore be based on reliable evidence for a different risk profile, otherwise we would be artificially distorting the investment policy of companies, which should be based on sound risk management practices. EIOPA has been analysing this topic for some time and will provide its final results in a report to the European Commission this autumn.

In the discussion about potential changes important elements of the already existing framework are sometimes forgotten: Solvency II allows insurers a large degree of flexibility in investing. Moreover, studies analysing the effect of Solvency II on investment behaviour often disregard the increase in the capital charge resulting from any mismatch between assets and liabilities. As a result, Solvency II provides incentives to invest in long-term debt infrastructure debt (e.g. Europe 2020 Project Bonds).

So we have long term assets and long term liabilities; how should Solvency II deal with this "perfect match"? The response is simple: just let the relationship develop, without interference, and it will flourish. In other words, Solvency II should be risk neutral, meaning same risk same capital charge, not pushing insurers artificially to invest in given assets. There is evidence in today's investing decisions by insurers that a neutral framework allows for investing in infrastructures, and that a risk based one encourages sound ALM and diversification, thus rewarding investing in long term assets. ■

## EIB is playing its role to finance real investment supporting jobs and growth

**Werner Hoyer** - President, **European Investment Bank (EIB)**

Since the beginning of the financial crisis, the European Union has agreed a number of institutional changes in macro-economic and budgetary coordination and surveillance and has made important progress in establishing the framework for a more resilient financial sector. This will soon be complemented by the Banking Union.

In spite of the remarkable progress achieved, important challenges remain in the short-term as well as in a longer-term perspective. The fragmentation of the EU financial space along national boundaries shows no sign of abating and puts at risk the integrity of the single market; the deleveraging of the banking sector weakens borrowers most dependent on banks; and the transition from a bank-centric financial system to one more balanced between banks and capital market is progressing slowly.

The European Investment Bank is playing an active part in dealing with these challenges and to support the financing of growth-supporting investment in the European Union.

Supported by the EUR 10bn fully paid-in capital increase, EIB is increasing lending and tailoring its interventions to local circumstances so as to maximise its impact. The EIB Group is increasing finance for SMEs to EUR 19bn (via loans, guarantees and venture capital) and is introducing new instruments to alleviate specific constraints as in the case of trade finance arrangements for SMEs located in "weak" countries.

Beyond purely quantitative elements, the EIB is also extending the provision of technical support to develop better projects and better policies, for example via EPEC (European PPP Expertise Centre) to disseminate Public-Private Partnership (PPP) experience and best practice. This should facilitate the transition to a more market based financing. Finally, the project bond initiative has now reached the market with the first transaction launched in July.

The extremely positive reaction to this transaction supports the view that it is a useful tool to ensure more capital market financing of real investment and further demonstrates the catalytic role of the EIB. The financial crisis has called for many adjustments in the architecture of the European Union.

The key role of the EIB has been recognised and the EIB is doing everything possible to help return Europe to sustainable growth and jobs. ■

## Long-term investment: hedging or real economy instruments instead of derivatives?

**Sharon Bowles** - MEP, Chair, Committee on Economic and Monetary Affairs, **European Parliament**

Concern over long-term infrastructure is not new but was put on hold in favour of the G20 regulatory program. That program impairs investment with emphasis on liquidity and the easily tradable rather than locked-in investment.

Parliament attempted to introduce incentives for infrastructure investment into CRD4. The Council and Commission did not want to break rank and follow that line. The situation is made worse by some supervisory pronouncements about insurance needing more bank-like treatment. Similarly, for insurers to be lumped into the 'shadow banking' category, when there is longstanding prudential regulation in Europe, is a further dampener to confidence. In part, eyes have turned to the public sector represented by Central Banks and the EIB, to encourage the re-emergence of securitisation and provide seed capital.

Some countries outside the EU benefit from having larger pension funds, and work in some Member States to pool pension fund resources is a worthwhile move. However, it is not clear that the Commission proposal on infrastructure investment will unlock new funds, or remove barriers. Institutional investors will want to establish hedges and there are concerns in the investor community that the Commission proposals do not allow that. I regret that hedging, when done, will be by derivatives rather than by diversity and long and short holdings.

There is room for regulatory encouragement here, but supervisory demand for precision is a block. For individual investors, maybe there could be some innovative thinking as to how to provide access to liquidity other than through early redemption. Could repo instruments, so vital in banking and other areas of finance, in some limited way be made available at a retail level to allow temporary access to liquidity instead of redemption? Would this be a way to use public liquidity rather than capital? ■

## Developing long-term financing which meets investors' needs

**Martin Parkes** - Director, Government Affairs & Public Policy, **BlackRock**

Long-term financing is the bedrock of the EU economy. Diversifying funding for the economy with the potential for more consistent growth and greater resilience to market volatility will only be achieved if the needs of end-investors are taken into account. This means understanding the various liquidity and investment needs of investors in the context of their short and long-term liabilities.

Long-term investing comes in many forms and is not limited to the provision of capital to private issuers, securitisations or unlisted projects. Indeed, investors typically hold liquid traded securities for the long term. Retail investors may have some of the longest-term investment needs of any economic player with liabilities stretching many decades into the future but they guard against unpredictable short-term liabilities by holding liquid assets.

Asset managers must act in their clients' best interests as a fiduciary with the aim of achieving the client's mandate. Their clients range from large institutions to individual retail investors.

We see growing demand from institutional clients for long-term illiquid assets such as infrastructure debt and equity, corporate loans and commercial real estate as an alternative to investment-grade corporate and sovereign debt.

Accelerating greater allocations to alternative long-term investments will come from a combination of contractual certainty and a coherent regulatory framework to avoid excessively high risk premia; accurate and standardised data to allow asset managers to perform due diligence and risk monitoring; appropriate prudential treatment for long-term assets; incentives to invest in vehicles such as the ELTIF and a 'passport' to encourage investment in new asset classes as non-bank loans. The greater the policy focus is on delivering a supportive regulatory framework, the greater investors' ability will be to invest in long-term assets. ■

## The need for financial engineering in infrastructure financing in Europe

**Franco Bassanini** - Chairman, **Cassa Depositi e Prestiti SpA**

With the financial crisis, project financing has proven more challenging. especially for greenfield projects, but also more necessary, considering the lack of public budget resources under the fiscal compact regime. Since 2008, the project finance volumes in the EU27 took a disproportionately large drop, due to the decline in bank lending. The European infrastructure finance market is in a transition from a model dominated by bank financing to one in which many actors play a role, such as institutional investors, infra funds, pension and life insurance platforms, banks, multi-lateral and national development banks, sovereign wealth funds and other private sector investors. The on-going evolution of this increasingly diverse market will require the various stakeholders developing new and innovative financial instruments capable of efficiently allocating available capital to projects.

Financial engineering may be essential. The new innovative financial instruments must be compliant with the emerging post crisis regulatory regime, which itself still needs more and brave policy actions and a general fine-tuning recalibration (on capital charges, information platforms, standardization of public procurement schemes, fiscal incentives, corporate governance, legal and regulatory environment, both in terms of land planning and licensing and in terms of sector-specific regulations that shape the cash flows, etc.).

Some of the potential solutions are already in place, i.e. the EU Project Bond Initiative and the Marguerite Equity Fund, new ones are under study at the EU Commission, others are currently been rolled out, and as such may need to be scaled up, and in some cases recalibrated or adjusted. There is no single solution for addressing the challenge of increasing direct market funding of infrastructure.

Solutions will lie in the development of a range of customized and tailored financial mechanisms and instruments which may differ by typology of projects, by sectors and by countries. ■