Infrastructure investments and insurance companies

regulatory changes, open issues and relevant initiatives

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Agenda

- Investing in infrastructure
- Infrastructures: definitions and categories
- Solvency II
- Technical and regulatory barriers
- Main issues
- ANIA working Table
Investing in infrastructure

Main reasons of interest:

- Low correlation with the business cycle, other investments and market volatility
- Duration suitable for the investment horizon
- Stable cash flows and inflation protection

Institutional investors may invest in projects:

- Greenfield: under construction
- Brownfield: in an operational phase
  - More stable financial flows
  - Lower risk of construction
  - Lower political risk
Infrastructures: definitions and categories

Social infrastructure

✓ Social housing
✓ Assisted healthcare residence
✓ School building
✓ Cemeteries [...]

Network infrastructure

✓ Of road transport and mobility management
✓ Of rail transport
✓ Of marine transport
✓ Ports, airports and logistic infrastructures [...]

Energy infrastructure

✓ Electricity and/or thermal energy production (traditional/renewable sources)
✓ Energy recovery and treatment
✓ Energy efficiency
✓ Gas and power supply
✓ Water [...]

Telecommunications

✓ Fixed networks
✓ Mobile networks
✓ Technological hubs [...]

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Edoardo Marullo Reedtz – Infrastructure investments and insurance companies
## Infrastructure by nature of economic flows

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RAB</strong></td>
<td><em>Regulated Assed Base</em>, remunerated investments based on pre-established criteria, for example remuneration on the investment made in relation to the market rates.</td>
<td>Large transmission and distribution infrastructures</td>
</tr>
<tr>
<td><strong>Concession with regulated rates</strong></td>
<td>Multi-year concessions for the exploitation of activities of public interest, with regulated tariffs.</td>
<td>Car parks, motorways, railways</td>
</tr>
<tr>
<td><strong>Long term contract</strong></td>
<td>Long-term contracts with buyers, with take-or-pay or take-and-pay mechanism, or with availability charges.</td>
<td>Plants from renewable sources, plants for the exploitation of raw materials.</td>
</tr>
<tr>
<td><strong>Market prices</strong></td>
<td>Revenues based on market logic, possible uncertainty.</td>
<td>Totally private infrastructures, with pure market logic.</td>
</tr>
</tbody>
</table>
Solvency II
The new risk-based approach

Solvency II introduces a risk-based approach and **radically changing** the **criteria and conditions** for the **eligibility of investments**. The new prudential rules tend to:

- **Favour**
  - Traditional investments
  - Direct investment rather than «securitization»

- **Discourage**
  - Investments in shares
  - Investments in low-rated bonds

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Subsequent amendments integrated the Delegated Regulation no. 35, providing **facilitations, in terms of capital requirement, for certain types of investments**:

- **September 30, 2015**
  (Effective from April 2017)
  The EU Delegated Regulation 2016/467 of 30/09/2015 introduces the art. 164a, which defines the criteria for identifying investments in entity responsible for infrastructure projects worthy of facilitated treatment (in the form of bonds/loans and/or equity).

- **June 8, 2017**
  (Effective from September 2017)
  The EU Delegated Regulation 2017/1542 of 08/06/2017 introduces the art. 164b, which extends the facilitated treatment to investments in infrastructure companies (in the form of bonds/loans and/or equity), with some appropriate differentiations both in terms of eligibility criteria and capital requirement.
# Solvency II

## Equity investments: standard vs. infrastructure

**Equity risk for the calculation of the capital requirement for equity investments:**

<table>
<thead>
<tr>
<th>Type of investment</th>
<th>Basic capital requirement</th>
<th>+ Adjustment (s.a **)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Type 1*</td>
<td>39%</td>
<td>s.a.</td>
</tr>
<tr>
<td>Equity Type 2</td>
<td>49%</td>
<td>s.a.</td>
</tr>
<tr>
<td>Private Equity</td>
<td>49%</td>
<td>s.a.</td>
</tr>
<tr>
<td>Hedge Funds</td>
<td>49%</td>
<td>s.a.</td>
</tr>
<tr>
<td>Infrastructure Entity</td>
<td>30%</td>
<td>77% s.a.</td>
</tr>
<tr>
<td>Infrastructure Corporate</td>
<td>36%</td>
<td>92% s.a.</td>
</tr>
<tr>
<td>Partecipazioni strategiche</td>
<td>22%</td>
<td>-</td>
</tr>
<tr>
<td>Property</td>
<td>25%</td>
<td>-</td>
</tr>
</tbody>
</table>

- For “eligible” infrastructure investments, **capital absorption** may be **significantly lower** than other types of equity investments:
  - 31.8% vs 51.4% if infrastructure investment through SPV ****
  - 38.2% vs 51.4% if investment in infrastructure companies****

(*) **Equity type 1**: (i) capital instruments listed on regulated markets of member countries of the European Economic Area (EEA) or the OECD; or (ii) equity instruments held as part of collective investment undertakings which are (iii) qualifying social entrepreneurship funds in accordance with the relevant regulation of these funds (346/2013 / EU; (iii) qualifying venture capital funds in accordance with the relevant regulation of these funds (345/2013 / EU); (iii) closed funds that do not use leverage and are based in the Union or marketed in it pursuant to the AIFM Directive (2011/61 / EU); (iv) European long-term investment funds (ELTIF) pursuant to regulation (EU) 2015/760.

(**) **Equity type 2**: Investments in equities other than equity types 1.

(***) **s.a.** = symmetric adjustment: symmetrical adjustment of the equity capital charge applied to hedge the risk deriving from changes in the price level based on a function of the current level of an adequate stock index and a weighted average level of that index.

(****) **Hypothesis**: **s.a.** = 2.4% (value as at 29/09/2017), investments considered as equity type 2.
Solvency II

Bond investments: standard vs. infrastructure

Examples of capital requirement for different forms of debt (bonds and loans *) with a BBB rating and 10y duration:

<table>
<thead>
<tr>
<th>Type of investment</th>
<th>Capital requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>BBB rated corporate (10y)</td>
<td>20%</td>
</tr>
<tr>
<td>BBB Infra corporate (10y)</td>
<td>15%</td>
</tr>
<tr>
<td>BBB Infra project (10y)</td>
<td>13.4%</td>
</tr>
</tbody>
</table>

NEW

For “eligible” infrastructure investments, capital absorption can be significantly lower than other types of bond investments, with the same rating and duration-

Spread risk for the calculation of the capital requirement for some forms of debt (bonds and loans *):

![Graph showing spread risk over duration](image-url)
Technical and regulatory barriers

**Absence of a strategic investment model** to support the State including:
- action mapping
- a detailed business plan of the single initiative
- the explanation of the methods of private participation and operational investments management
- an adequate information system

Insurance business model generally **adverse to high risk assumption**

**Internal analysis structures often not adequate** and no relevant experience in evaluation and management of projects, especially for greenfield projects.

**Little interaction** between Solvency II and Juncker plan projects

**Eligibility criteria** of the investment to the facilitated treatment in some cases of difficult interaction with the real world
Main issues

- Identifying projects
  - Lack of available projects
  - Existing pipeline not much investable
  - Origination of activity cost intensive
  - High *time to market*

- Evaluation attractiveness of project
  - Limited availability of necessary information
  - Low quality available information
  - Presence of high administrative risks

- Operation structuring and financing
  - Limited access to *credit enhancement*
  - Competition of banks on short-term debt
  - Presence of high administrative risks

- Asset management and exploitation
  - Regulatory risks with retroactive effects
  - Operating partner with equity participation

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1 Times of approval and obtaining permits, regulatory changes, release of funding
ANIA working Table

the initiative includes the involvement of four key players

- **Government**
  - Contribute to the access to strategic projects
  - Promote access to credit enhancement
  - Execution risk reduction

- **CDP/ EIB / ...**
  - Provide credit enhancement
  - Support origination

- **IVASS / CONSOB**
  - Facilitate investments
  - Regulatory clarity

- **National representatives**
  - Facilitate Origination
  - Creation of lasting partnerships
  - Identification of the country's needs