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Solvency II: A Double Edged Sword For Infrastructure Investment?

Practical Solvency II For Life Actuaries, Institute And Faculty of Actuaries

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Solvency II and Infrastructure

Drivers of infrastructure investment?

- **More than standard formula calibration**
- **More than matching adjustment**

Domain of the most sophisticated?

- **Approved internal models**

Could Solvency II promote a more disciplined approach to infrastructure investment?

The Case For Infrastructure

A Funding Gap

- \$3.4 trillion in total, \$500 billion per year

Attractive Yield: Credit spread of 1% to 2%

- 4% to 5% yield from PFI bonds vs 3% yield from sovereign debt

Lower Annual Default Rate

- 1.5% for project finance debt vs 1.8% for corporate bonds

Higher Recovery Rate

- 75% for project finance debts vs 45% for corporate bonds

Diversification

- Low correlation with other asset classes

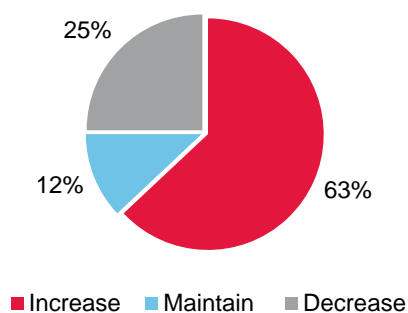
Liability Match

- Long term investment horizon

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Investor Demand

Allocation to infrastructure over next 12 months



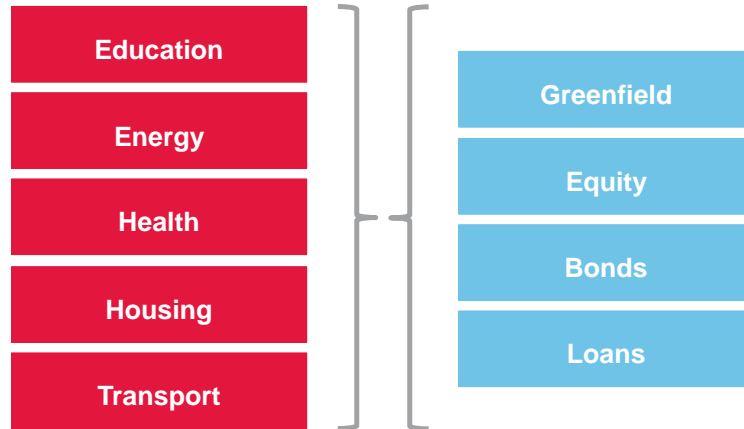
- UK Insurance Growth Action Plan: £25 billion
- AXA: €10 billion
- AG Insurance: €3 billion
- CNP Assurances: €2 billion

Source: Preqin Investor Outlook Alternative Investments H1 2014

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What Is Infrastructure Investment?

“heterogeneous and relatively new asset class”, EIOPA



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Standard Model Calibration

No tailored charges for infrastructure investments

- Function of whether listed/unlisted/equity/loan

Implications:

- Not treated as a distinct asset class
- No specific diversification benefit
- Does not account for specific default and recovery prospects

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Matching Adjustment

“What is important from the PRA’s perspective is that a firm holds sufficient capital against the risks of its investments and that has

- the right expertise
- information and;
- systems

to be able to manage the risks of those investments both at the underwriting stage and in its subsequent monitoring of the exposure.”

Andrew Bulley, Director of Life Insurance, Bank of England

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Not For The Faint Hearted

Regulatory and
political risks

Construction risk

Liquidity risk

Hard to benchmark
and value

Lack of industry data

Lack of knowledge
and experience

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Conclusion

Tempting, but not straight forward asset class

- **Potential to increase yields**
- **Potential to reduce asset-liability mismatches**

Necessary expertise likely to be limited to a few

Availability of suitable projects

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Thank You

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S&P's Related Research

Investing In Infrastructure: Are Insurers Ready To Fill The Funding Gap?, July 7, 2014

Solvency II Could Be A Double-Edged Sword For Infrastructure Investment, July 7, 2014

Global Infrastructure: How To Fill A \$500 Billion Hole, January 16, 2014

How To Unlock Long-Term Investment In EMEA Infrastructure, October 4, 2013

Project Finance Default And Recovery: Shale Gas Fuels Rise in U.S. Defaults, August 9, 2013

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