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# Current issues

## Opportunities in infrastructure investment

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In this article we discuss three drivers that point to an increasing demand and opportunity for investments in infrastructure. Insurers play a key role in meeting some of these challenges, from supporting economies to 'build-back better' as we emerge from the COVID-19 pandemic, to transitioning their balance sheets for net-zero, whilst looking to protect investments from inflation.

## Disruption driving demand and opportunity

There is a renewed sense of optimism that we are at the end of the reoccurring lockdowns as the final COVID-19 restrictions are lifted. However, there are many lasting impacts from this pandemic. Globally, governments have recognised the benefits of a post-pandemic economic recovery grounded with strong infrastructure spending, thus driving an increasing demand for investment in this area. In addition to having environmental and social benefits, improved infrastructure can help address supply chain issues, building more resilience into the economy.

Pandemic delays, underinvestment, the postponed flow of capital from previous Brexit uncertainty, and a stronger focus on sustainability all pave the way for a strong pipeline for investment opportunities in infrastructure.

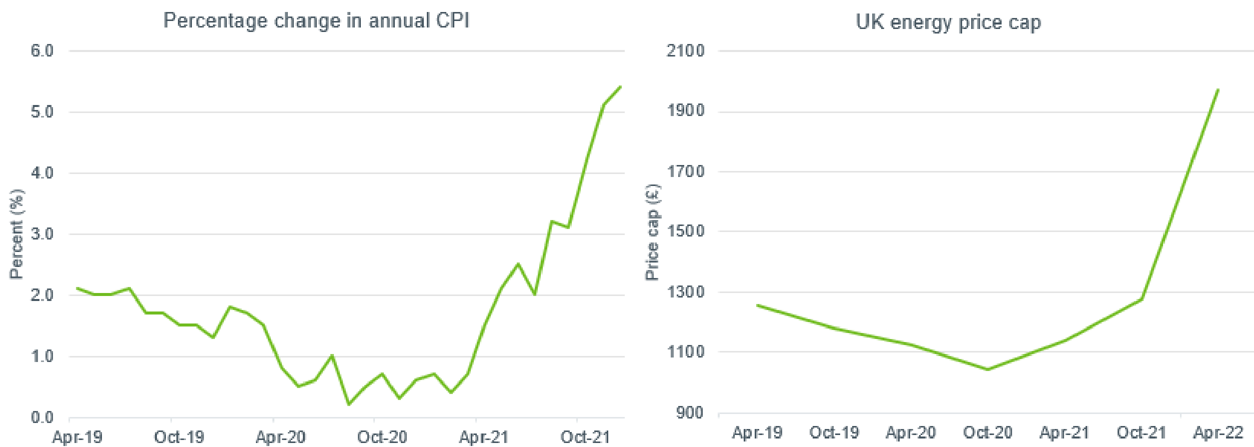
In its paper "Transforming Infrastructure Performance: Roadmap to 2030", the UK's Infrastructure and Projects Authority estimates £650bn of projected public and private investment is required over the next ten years. Other governments have announced similar large-scale infrastructure projects such as the US's Build Back Better programme and the EU's Connecting Europe Facility. Additionally, as governments commit to stronger climate change targets, the pipeline is likely to expand further in the race to net-zero.

Governments are planning to partner with the private sector to help fund infrastructure. The UK's Chancellor Rishi Sunak last year set up the UK Infrastructure Bank to help harness investment in specific infrastructure projects, with initial funding provided from national and local government, that is expected to stimulate further private sector investment.

## Inflation

The UK is currently experiencing an inflation and cost of living crisis predominantly caused by supply chain issues and rising energy costs. Many will remember the delays when buying certain goods; queuing for hours for petrol; or even being unable to get a milkshake from their favourite fast-food chain. Supply chains have been weakened for a mix of reasons including but not limited to worker shortages, border closures, and rigorous hygiene procedures.

More recently, rising energy costs have presented a new challenge for the government as political pressure grows to help reduce energy costs for consumers. The energy price cap that limits the amount utility suppliers can charge consumers is shown in the charts below, alongside the increase in inflation.




On the inflation chart on the left, CPI has risen from just above 0% to above 5% in the space of the year. Similarly, the energy price cap chart on the right shows a 54% increase. Whilst central banks are taking actions to try to stem rising inflation, insurers often seek to protect against inflation risk and infrastructure investments can provide the opportunity to manage that risk.

## Sustainability

As Mark Carney, the former Bank of England Governor and current UN Special Envoy for Climate Action and Finance, says “Only the mainstream focus can finance the estimated $100 trillion of investment needed over the next three decades for a clean energy future”. Better infrastructure is vital for increased (and likely cheaper) renewable energy production and therefore, by extension, vital for the transition to a low-carbon economy.

Insurers are increasingly focused on managing climate risk; facilitating this energy transition; and reaching their own net-zero commitments. To achieve this, they are looking for more sustainable investments and to limit investments in sectors that are likely to suffer as economies transition towards net-zero. With sustainable sectors such as renewable energy, infrastructure could perform well in the transition, switching the focus from transition risks to transition opportunities. Furthermore, investing in sustainable infrastructure projects is a positive proactive approach to seriously incorporating climate factors into an investment portfolio.

### Some examples of infrastructure investment

**Rail networks**

**Water services**

**Onshore/offshore wind**

**Telecommunications**

**Flood defence**

**Electricity interconnectors**

## Infrastructure benefits an insurer’s allocation

Insurers can typically access infrastructure in either a debt or equity format, with the former potentially being eligible for matching adjustment portfolios if certain criteria are met. There are some key benefits for insurers:

**Asset and Liability Management**

Infrastructure investments typically produce a stream of reliable cashflows that can be either fixed or index-linked. Such assets if index-linked can provide protection against rising inflation whilst generating additional yield over index-linked bonds or gilts.

Insurers with approval for the use of infrastructure investment in their matching adjustment portfolio have already been taking advantage of an infrastructure allocation for a number of years. Maturities for infrastructure debt are often around 10-15 years, in line with the typical duration of an annuity portfolio, providing useful cashflow matching attributes for matching adjustment portfolios as well as capturing an illiquidity premium in the matching adjustment.

**Diversification**

Infrastructure assets can help insurers build a more diversified portfolio, as infrastructure assets historically have tended to be less affected by the economic cycle compared to some other asset classes. Infrastructure encompasses a wide range of assets, including sectors such as energy and flood defence. Therefore, certain sectors in an economic downturn are less likely to experience widespread defaults. Similarly, infrastructure equity may supplement an insurer’s listed equity allocation due its different risk and return characteristics and drivers compared to other listed equities.

The main risks to infrastructure investments are driven by regulatory and political changes. However, this risk is likely to be reduced relative to previous years as governments and regulators appear keen to drive more infrastructure investment. This drive may lead to a build-up of incentives encouraging investment.

We know the UK regulator is reviewing and consulting on how to reform the insurance capital regime in the UK, where one of the review areas is the asset eligibility rules for the matching adjustment portfolio. Reform in this area could provide for an increased role for further investments and opportunities in ESG-focused infrastructure. In recent times, the changes to the “qualifying infrastructure” rules have served to reduce capital charges for infrastructure equity and debt, if particular conditions are met. Under the Solvency II Standard Formula, infrastructure debt meeting the set conditions can benefit from a reduced capital charge of c.70% of that applied to other bonds and loans of the same duration and credit rating. For investments in infrastructure equity projects, the equity stress is 30%, compared to the general equities stress of 49% or 39% for listed equity.

**Challenges**

From our conversations with insurers, it is unsurprising that many are planning to increase their investment in this area, given the key benefits discussed above. There are challenges to investing in infrastructure which will need to be factored into strategic asset allocation, particularly liquidity and constructing a diverse infrastructure portfolio. However, these are challenges that can be overcome:

- Liquidity - managed by understanding liquidity requirements at a total portfolio level to ensure there are enough liquid assets to meet liability cashflows.
- Diverse portfolio - managed by selecting a suitable asset manager and working with them to achieve this, or by developing in-house capabilities.

## How Hymans Robertson can support you

Hymans Robertson has extensive experience assisting insurers as they develop and optimise strategic asset allocations, alongside manager selection processes to help find a good match to an insurer's unique requirements. We have also helped firms with matching adjustment applications and approvals. We are happy to discuss any aspect of infrastructure investment with you.

If you would like to discuss this with one of our specialists, please get in touch.

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