UK Infrastructure Regulation: opportunities to align the interests of investors and consumers

London, 8 September 2016

9.30am Welcome by **Charles Currier**, Partner, CMS Cameron McKenna

9.35am Keynote by **Dermot Nolan**, Ofgem CEO and UKRN Chairman
Contemporary UK regulation – opportunities and challenges

10.00am Panel discussion
Investor and regulator perspectives on managing change in a market
Dermot Nolan, Ofgem CEO
Robert Lane, Partner and Head of Regulated Industries, CMS Cameron McKenna
Harry Seekings, Partner, InfraRed Capital Partners

10.45am Coffee break

11.15am Keynote by **Julia Prescot**, Chief Strategy Officer, Meridiam
Understanding and managing regulatory risks – an investor journey

11.45am Panel discussion
Investors, consumers and social goals
Andrew Haines, CEO Civil Aviation Authority
Dan Brown, Strategy Director, ORR
Niall Mills, Head of Infrastructure Asset Management, Europe, First State Investments

12.30pm Lunch

2.00pm Panel discussion
Benchmarking risks and returns in infrastructure investments
Aileen Armstrong, Senior Director of Finance and Networks, Ofwat
Eugene Zhuchenko, Executive Director, LTIIA
Raffaele Della Croce, OECD Lead Manager, Long Term Investment Project

2.45pm Coffee break

3.15pm Panel discussion
Alternative approaches to financing regulated infrastructure
Philippa Eddie (invited), Head of Financial Advisory, Infrastructure and Projects Authority
James Wardlaw, Partner, Campbell Lutyens
Richard Price, Adviser, Infrastructure and Environmental Finance

4.00pm Concluding remarks by **Eugene Zhuchenko**, Executive Director, LTIIA

Brendan Malkin, Editor of InfraNews, will moderate panel discussions

RSVP to c.andre@ltiia.org before 1 September 2016
Participation fee £500 per person.
LTIIA members, institutional investors and invited officials attend for free

hosted by **CMS Cameron McKenna LLP**
Cannon Place, 78 Cannon Street | London EC4N 6AF | United Kingdom

UK Regulators Network

Contemporary UK regulation – opportunities and challenges

Dermot Nolan
Ofgem CEO and UKRN Chair

8 September 2016

UK Regulators Network – Investor community

- The UK is in a period of significant change – politically, economically and technologically. The pace and breadth of change creates opportunities and challenges for regulators.
- Our approach to this is to establish a stable and predictable regulatory regime.
- We want to incentivise market participants and investors to work and innovate in this changing world to deliver the best outcomes for consumers and to deliver them efficiently.

UK Regulators Network – Who are we?

- UKRN is a member organisation made up of 13 regulators.
- Aims to encourage and build upon a culture of collaboration across the network and with our stakeholders.
- Intention of engagement with investor community is to take a broader look at the risks and opportunities to investment in UK regulated sectors.
- Facilitate discussions with the investor community on cross-cutting regulatory issues affecting regulated markets.
- Not intended to replace direct engagement with individual regulators on specific policy.

UKRN – What do we Regulate?

Much of what we regulate has traditionally been regulated through formal price controls which have a common set of regulatory characteristics and include:

- Water
- Energy networks
- Some rail
- Some telecoms
- Some airports

These are services that consumers usually see as essential services - classic utilities that were often initially state-owned monopolies.

There is also a significant group of activities that are regulated somewhat differently, including:

- Energy generation
- Most airports

Opportunities to align the interests of investors and consumers

- We regulate for consumers not investors but investment is essential.
- There must be a balance between investment returns and consumer benefit – if legitimacy is lost, political risk rises.
- Stable, independent regulation should provide an appropriate means of striking the right balance between consumer protection and a stable investment environment that provides reasonable returns.
- Events like this are an opportunity for investors to talk to us about their concerns – particularly stepping back to look at the UK regulatory environment as a whole.
- Process is important – as regulators we need to be aware of the impact of delays and changes to our processes.

Risk

- We are acutely aware of concerns about regulatory risk and risks relating to the legitimacy of the sector.
- We are focused on minimising regulatory risk as much as possible but this does <u>not</u> necessarily mean minimising change.
- Change in regulatory rules is necessary – we want to ensure that change is predictable and well explained
- Communication between regulators and investors about risk promotes an environment where risks are properly priced and low cost of capital benefits accrue to consumers.

Driving behaviour

- Regulation is increasingly focused on getting the not just the lowest-cost outcome, but one that generates the best overall outcome for consumers – and price controls processes across regulators are now seeking to involve consumer groups directly on what the right outcomes are
- A focus on outcomes, coupled with the significant change we are seeing in regulated industries, is pushing regulators to increasingly seek to empower industry to find the best way to deliver outcomes and manage change.
- Regulators need to incentivise the right behaviours.
- But investors also have a key role to play in influencing management behaviour.

Energy – an example

In energy - technological and policy change is leading to a radical restructuring of the industry that would have seemed highly unlikely only a few years ago.

- Energy was originally controlled by CEBG – at privatisation it was split into networks, retail and generation.
- Each group has historically had its own specific regulation characteristics but the distinctions have started to blur.
- The key driver of change has been technological advances.
- Changing technology → changing market → changing regulation and changing financial models.
- The important thing for us is to still have a strong flow of investment into the sector.

Difference models of regulation

- The regulation of monopolies vs other types of regulation come with their own unique set of challenges.
- Increasingly areas traditionally dominated by monopolies and regulated through traditional price controls are – mainly through technological change - being opened up to competition.
- UK regulators are offering a range of new, innovative opportunities for investors to engage in regulated industries – eg. Thames Tideway and the CATO and OFTO regimes.

Tideway

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UKRN/LTIIA Seminar

UK Infrastructure Regulation

Investor and Regulator Perspectives on Managing Change in a Market

Robert Lane, CMS

8 September 2016

– Legislative and Regulatory Framework

- Laws
- Licences/Authorisations
- Regulator

- Certainty
- Predictability
- Independence/Rules

- Structure and Detail
- Process for Change
- Checks and Balances

- Consultation/Engagement with Stakeholders
- Reasoning
- Appeals/Challenges

– Structure needs to be able to deal with:

- Change in Circumstances
- Change in Policy
- Left Field Issues…. Brexit

– Conclusions

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KEY TRENDS IN RENEWABLE ENERGY INVESTMENT AND FINANCING

OECD Business and Finance Outlook 2016

Raffaele Della Croce
Lead Manager, LTI Project,
Financial Affairs Division - OECD
raffaele.dellacroce@oecd.org

BETTER POLICIES FOR BETTER LIVES

Recent OECD work on long-term investment

Institutional investors and long-term investment project

www.oecd.org/finance/lti

- Large Network of LTI Investors (>3,000 members)

G20-OECD work on long-term financing

http://www.oecd.org/finance/private-pensions/g20-oecd-long-term-financing.htm

- the G20/OECD Task Force on Long-term Investment Financing by Institutional Investors

Recent key deliverables:

- G20/OECD Guidance Note on Diversification of Financial Instruments for Infrastructure and SMEs
- G20/OECD Support Note on Diversification of Financial Instruments for Infrastructure
- G20/OECD Support Note on Diversification of Financial Instruments for SMEs
- Annual Survey of Large Pension Funds and Public Pension Reserve Funds (last published 2016)
- the OECD is developing further work with the Chinese presidency of the G20 and is already planning next year deliverables with the German presidency

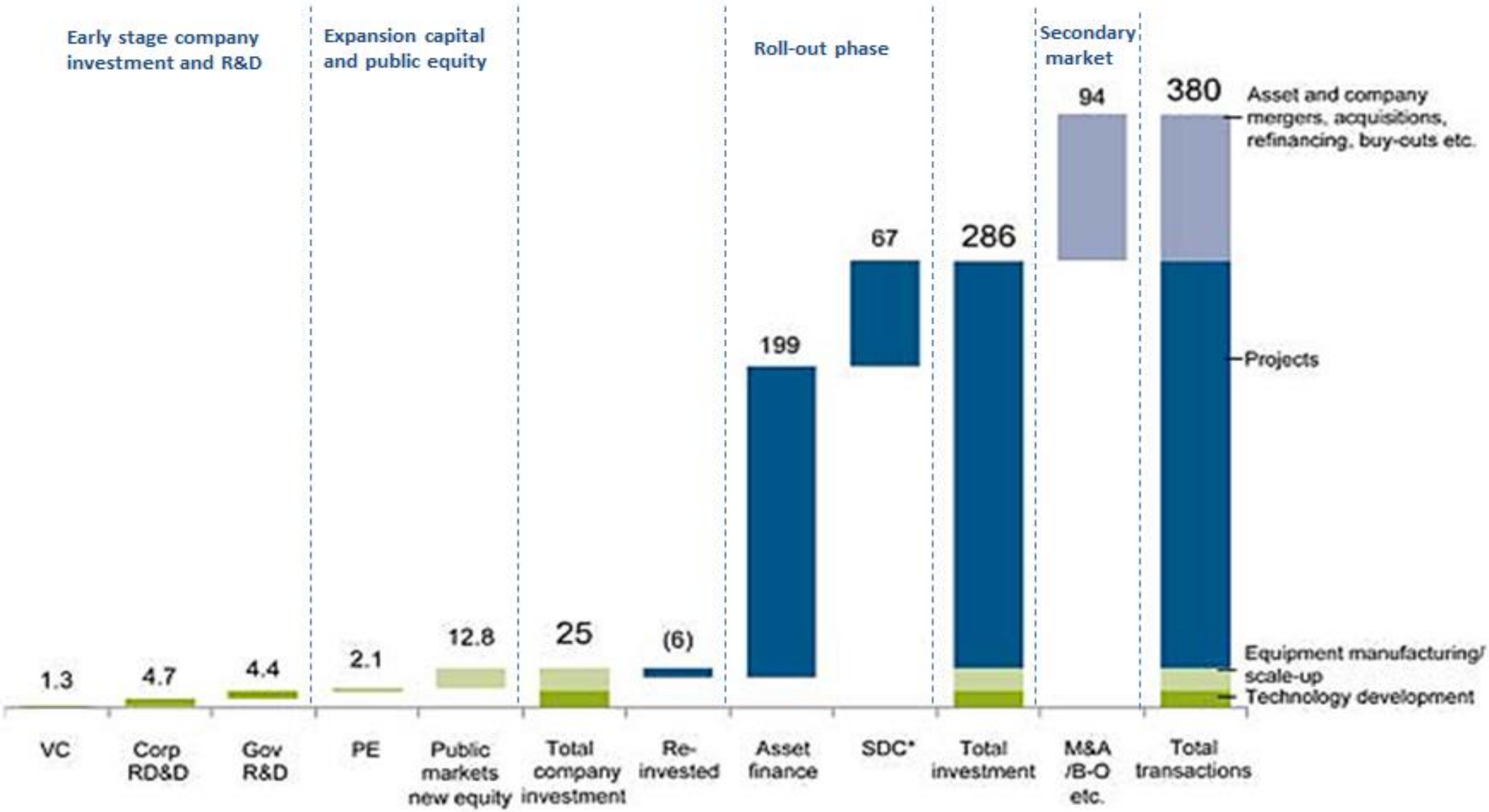
"The draft [Addis Ababa Accord] stresses the important role of private investment. Investment in sustainable infrastructure for example is recognised as a major cross-cutting driver that can contribute to achieving all the SDGs. In this regard, I welcome the work of the OECD and the G20 on High-level Principles of Long-term Investment Financing by Institutional Investors."
UN Secretary-General Ban Ki-moon
Keynote address at the OECD - 28 April 2015

Introduction: why focus on renewable energy?

- **Growing importance as an economic sector:**
  $286 billion new investment and 8.1 million workers in 2015
- **Global value chains** (e.g. solar PV and wind energy)
- Scaling up renewables investment is critical to address climate change and implement the **2015 Paris Agreement**
- **Economic benefits**, such as reduced local air pollution and improved energy security

Investment in renewable energy reached a new record in 2015

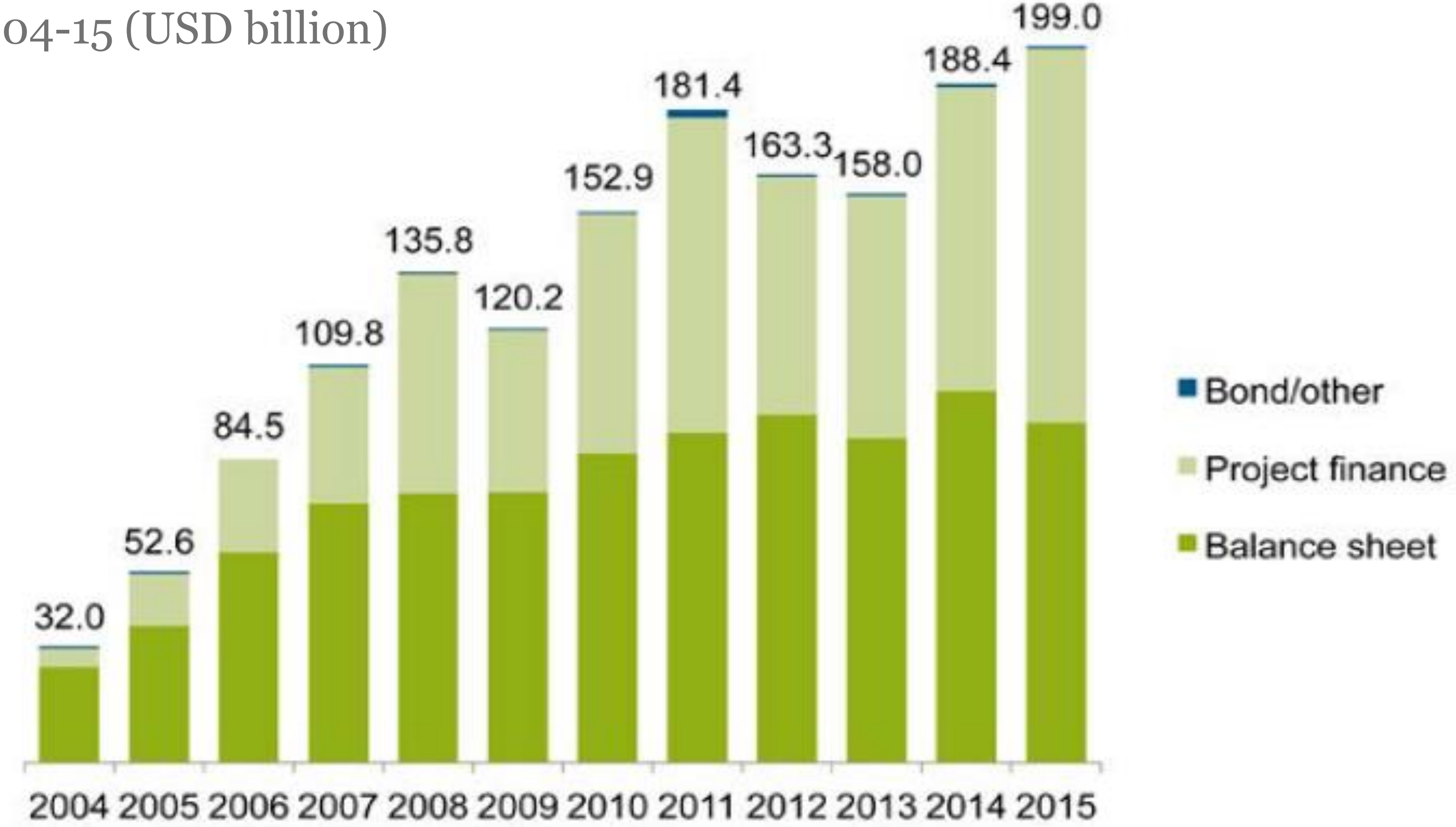
Renewable electricity (and biofuels) investment financing, 2015 (USD billion)



Source: Source: Frankfurt School - UNEP Centre, Bloomberg New Energy Finance.

Project finance is becoming more prominent

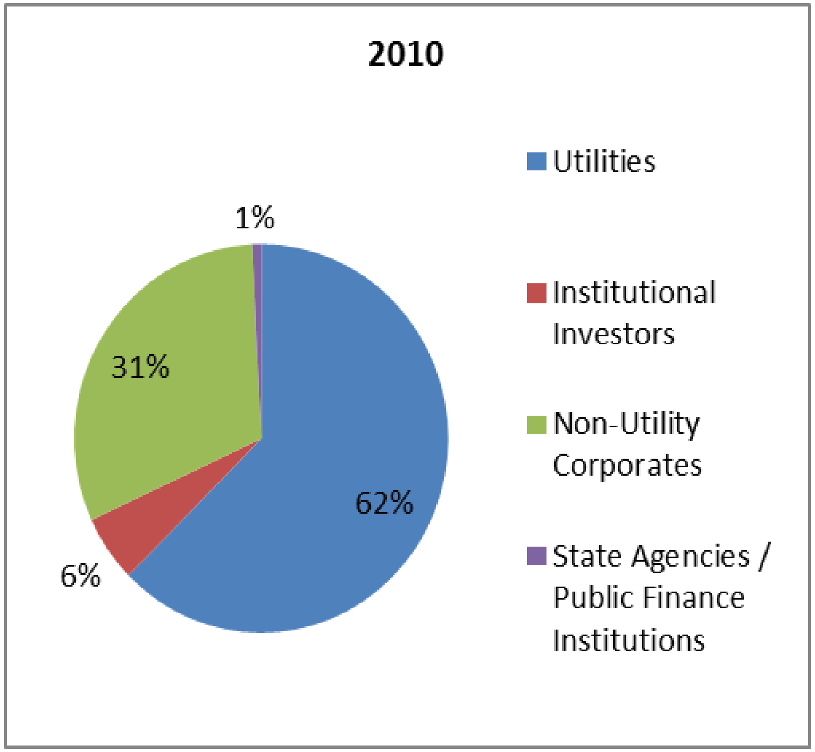
Asset financing of new investment in renewable energy by type of financing, 2004-15 (USD billion)

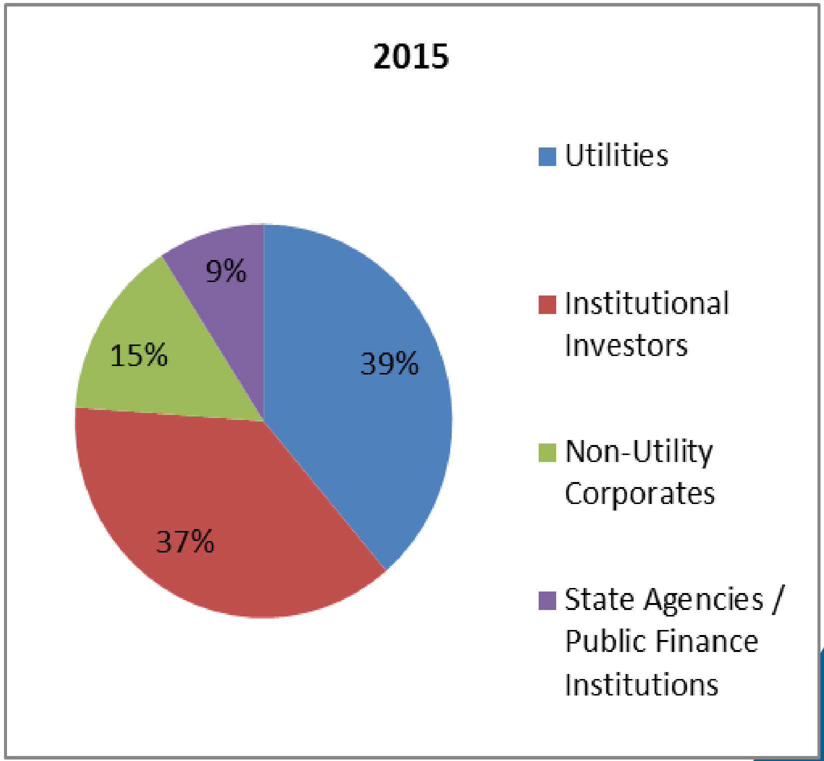


Source: Source: Frankfurt School - UNEP Centre, Bloomberg New Energy Finance.

The investor mix is changing, with increased activity from financial investors

Change in equity mix in wind energy projects in Europe



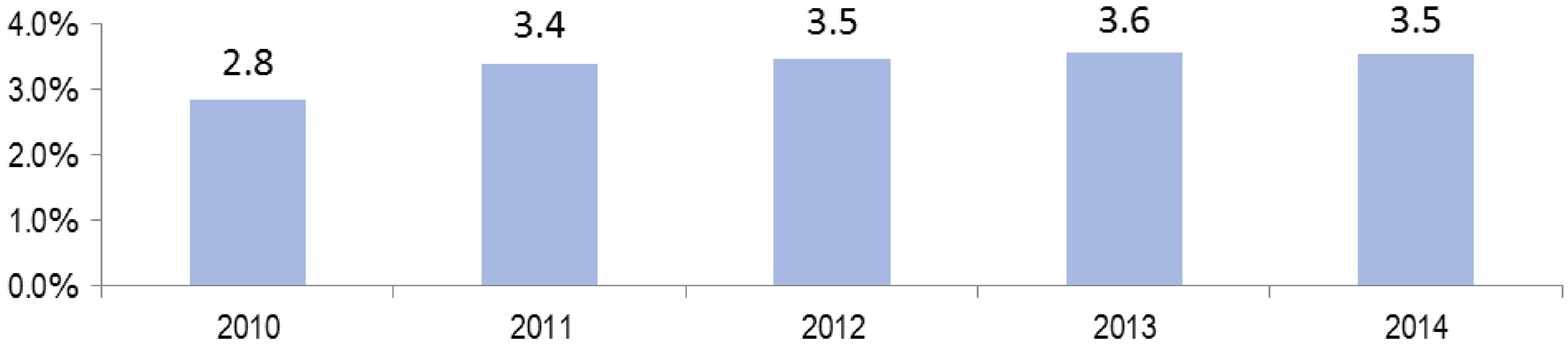


Source: OECD calculations based on BNEF data.

Renewable electricity infrastructure can offer an attractive return profile for long-term investors

Historical unlisted infrastructure equity allocation of select LPFs and PPRFs, 2010-2014

(As a percentage of total assets)



Source: OECD Large Pension Fund Survey 2015.

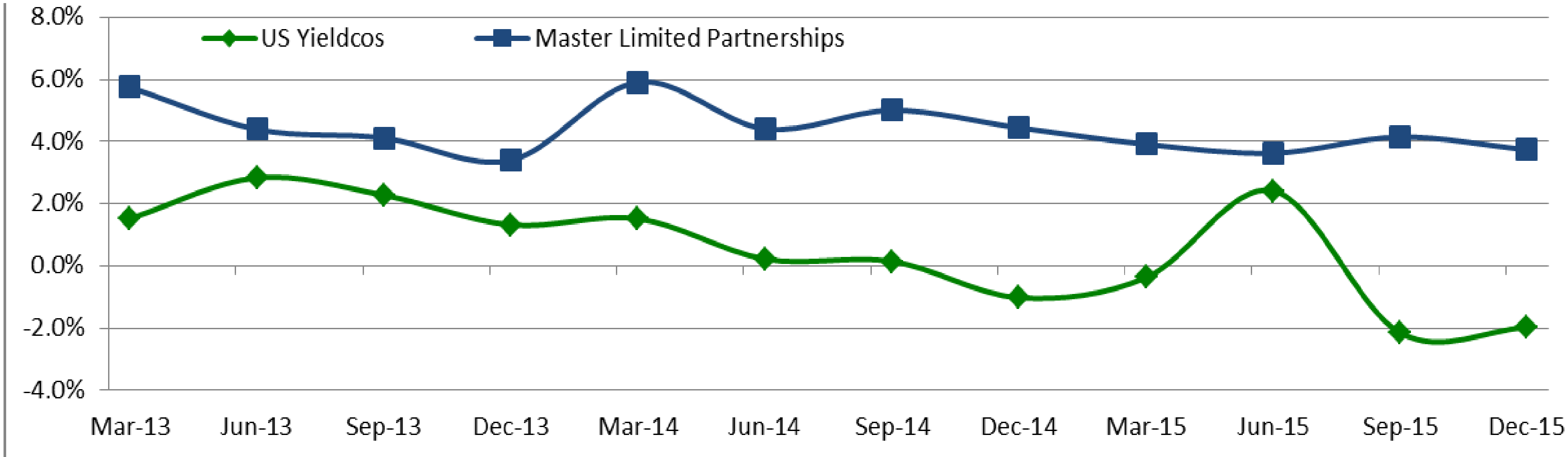
But challenges remain with these innovative and emerging instruments

- A young and unproven yieldco business model
- Short operational history, issues with transparency and governance
- Weak performance

→Yieldcos have not gathered wide acceptance yet

→ Closed end funds in the UK have proven to be more resilient

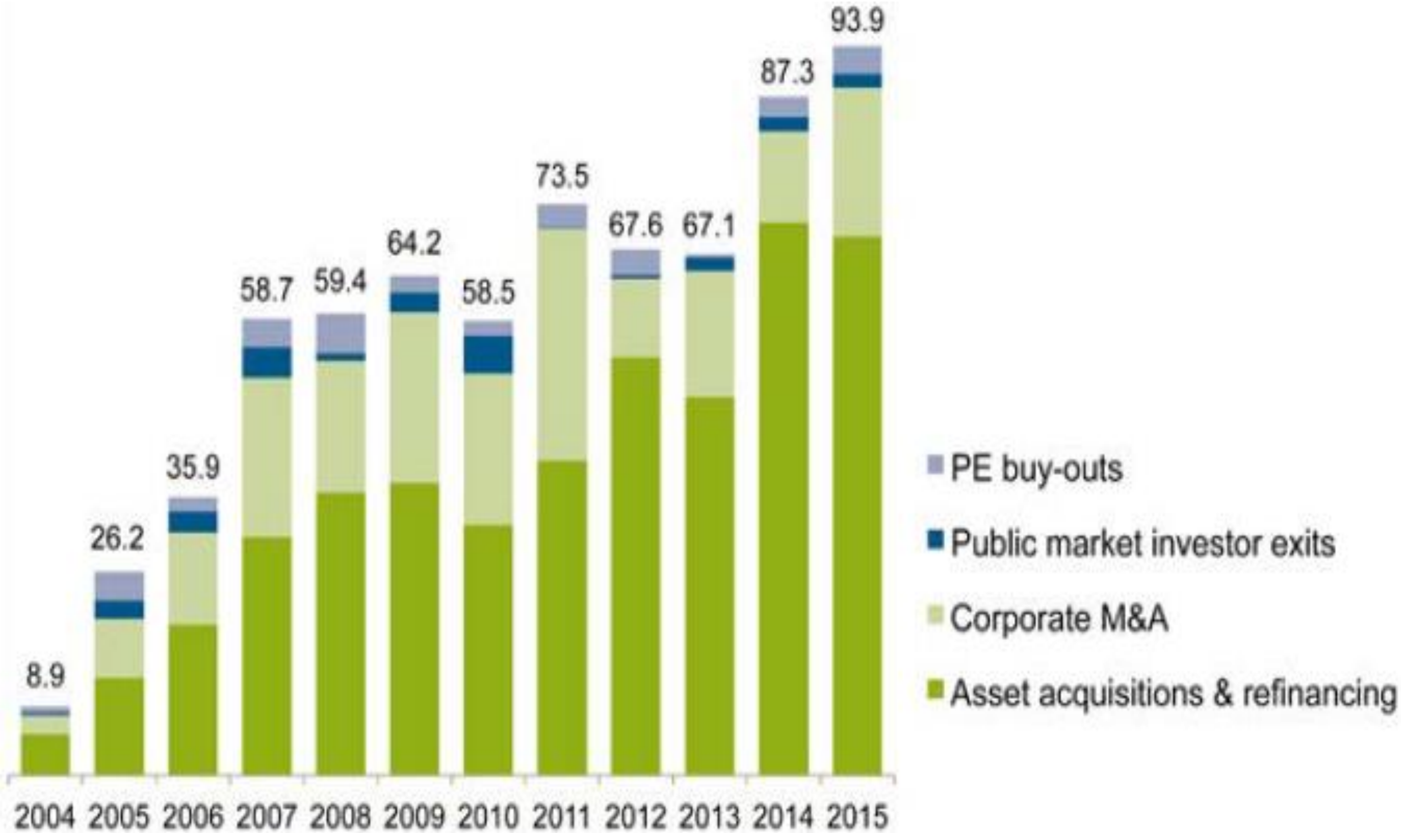
Average return on equity of five largest yieldcos and five largest MLPs, US based



Source: OECD calculations based on Reuters data.

A secondary market for renewable electricity projects has developed

Acquisition transactions in renewable energy by type, 2004-2014 (USD billion)



Source: Source: Frankfurt School - UNEP Centre, Bloomberg New Energy Finance.

Partnerships between different market participants have developed

- In particular, **utilities** have recently established joint ventures with **financial companies** to invest in renewable electricity
- The French utility **EDF** and **Amundi** have partnered in 2014 to create a joint asset management company that will finance energy-related projects.
- In Italy, **EDF** and **Edison**, two utilities, and the **infrastructure fund F2i** established the third-largest operator in the Italian renewable energy sector in 2014.
- In Germany, the utility RWE, along with 29 municipal utilities, established in 2010 **Green GECCO**, a joint-venture company for renewable projects which operates five wind farms to date.