Investment opportunities in UK infrastructure:
Economic regulation improves investor confidence, in the interests of consumers

Richard Price[1]

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I am very pleased to have the opportunity to speak directly to so many people with an interest in the UK's infrastructure, whether as advisors or investors. Thank you to InfraNews for having me here to speak today.

I am not going to talk to you primarily about rail today, but I want to tell you more about independent economic regulation and how UK regulators have come together to seek to improve opportunities in UK infrastructure to increase investor confidence and ultimately benefit consumers.

For over 25 years, regulated utilities in the UK have attracted investment from around the world to build and maintain our essential infrastructure and to ensure the provision of vital services. The role of independent economic regulation, designed to protect the interests of consumers whilst providing a clear and transparent regulatory framework for investments, has been key to that success.

Utility sectors in the UK, supported by our standard-setting regulatory regimes, have been viewed as models for other countries. But they are subject to changing requirements with an evolving economic and social context and significant levels of new investment required. The financial landscape is also evolving, with a more diverse and widely-spread investor base interested in investing in the UK.

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About the UK Regulators' Network

In March 2014, regulators in the UK made a new commitment to collaboration. This involves not only the core economic regulators for the 'network industries', such as Ofwat, Ofgem, Ofcom, the CAA and ORR but also other sector regulators such as the FCA and Monitor[2]. This is important because there are common strands through our work in areas such as consumer empowerment and choice. Notwithstanding three decades of experience of economic regulation in the UK, the work of each sector regulator has tended to remain distinct and highly sector-focussed; and has been seen as lacking a certain 'joined-up-ness'.

In fact, the UK's regulators have always shared information and experiences with each other in a fairly informal way. But we had no firm basis for sustained effort at collaborating on issues of common strategic interest. So the commitments we made in March 2014, as Chief Executives and through our entire organisations, give us for the first time really solid foundations for working much more effectively with each other.

This allows us to tackle areas of joint interest, areas where by working together we can do things better or more efficiently and where a collective voice is more powerful than many individual voices. As in everything we do, we expect to deliver better value for consumers, whether that's through improving the investment climate, improving our own performance and efficiency or empowering consumers to find the best deals for their circumstances, making our markets more effective and more competitive.

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2 UKRN is a network formed by the UK's economic regulators: The Civil Aviation Authority (CAA); The Financial Conduct Authority (FCA), including the Payment Systems Regulator (PSR); Office of Communications (Ofcom); Office of Gas and Electricity Markets (Ofgem); Water Services Regulation Authority (Ofwat); Office of Rail Regulation (ORR); Northern Ireland Authority for Utility Regulation (NIAUR). Monitor, the sector regulator for health, participates in the network and its projects as appropriate. The Water Industry Commission for Scotland (WICS) and Legal Services Board (LSB) are contributing members which generally participate in projects as observers. (Although it has competition and consumer protection functions, the FCA is not classed by HM Government as an economic regulator.)

Investors matter

So where do investors fit into all this? One of the objectives which we set out in our public statements last year was to work together to improve the environment for efficient investment in the UK's infrastructure. The strengths of our regimes are recognised: stability, predictability, tried and tested regulatory structures. A track-record of behaviour that has given investors the confidence to put hundreds of billions of pounds into UK essential infrastructure – in the order of £500bn since privatisation.

So while our number one priority is to deliver the right outcomes for consumers, we recognise that the investment community stands at the centre of the framework that delivers those outcomes. And we also recognise that, in a world with increasing and diverse opportunities for investment, anyone with an interest in delivering efficient financing has to recognise that they cannot take investors for granted, no matter how strong their track record. We need to do everything we can to ensure that investors properly understand how regulatory and investment regimes work, in order to help investors to understand where new opportunities lie.

None of this means that we regulators are going soft; certainly not. But as a group of regulators, outside the confined spaces of a price control process, we feel it gives us the opportunity for a different kind of dialogue between regulators and investors. And that is why I am here today.

An investor guide to UK regulated infrastructure

I hope investors might take an interest in a lot of the work we are doing, but there are two projects that are more likely to catch your eye. One has been creating an investor guide to UK regulated infrastructure. [3] As I've said, one of the clear opportunities in coming together in the Regulators Network was to take a new perspective on our regimes and how they are viewed by investors. So rather than speak individually, we wanted:

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3 UK Regulators' Network (2014): UK Regulated Infrastructure: An Investor Guide http://www.ukrn.org.uk/wp-content/uploads/2014/07/UKRN-Investor-Guide.pdf

- to communicate to investors about regulated infrastructure as a single asset class;
- to put infrastructure investments in their historical context; and
- to be clear about the investment needs for the future.

Given the scale of the UK's major investment requirements, we're sure that investors will appreciate the opportunities it creates for them. The guide aims to help investors to navigate across our sectors and seek out similar opportunities in adjacent sectors, perhaps with more focus on similarities of commercial structure and asset class than on the difference between water pipelines and electricity cables and runways.

Then there are those investors who are relatively new to the UK and our system of economic regulation. While we truly believe that our regulatory regimes offer a clear framework, resulting in good outcomes for consumers as well as a stable environment for investment, we can also appreciate that three decades of development can make for a fair degree of complexity. This is a situation in which terminology is taken for granted by some, but acts as a barrier to understanding for others; and where approaches are second-nature to those who have experienced them over many years, but are completely new to others.

And so the guide is intended to be a contribution to ensuring that all investors have the information they need to make sense of our regulated utilities and how we as regulators go about our work.

Regulatory independence

Perhaps more than anything else, what many investors struggle with is understanding regulators' relationships with government.

As I said, government has been very supportive of what we are doing. Indeed, publication of our investor guide follows the government's most recent National Infrastructure Plan, which continues to develop year on year to provide ever more clarity about the overall infrastructure landscape in the UK.[4]

4 HM Treasury: UK National infrastructure Plan

Through UKRN we have very good relationships with the Treasury and the Department for Business, Innovation and Skills (BIS). And each individual regulator works closely with the relevant Government department, such as DEFRA for water, DCMS for communications, and the Department for Transport for rail, roads and aviation. And we know that UK Trade and Investment does an excellent job working overseas to explain the benefits of investing in the UK, including in the industries that we regulate.

But working closely together, having strong relationships and sharing common aims does not prevent us as regulators from being independent in our actions.

That independence is set out in statute, defining our objectives in a way that is kept separate from the day-to-day pressures of politics. We consider the long-term needs of consumers in our sectors and by extension, the investment needed to deliver good-value, high-quality services.

Regulatory investment gives predictability to investors by providing a framework which also has sufficient flexibility for operational decisions to be made without political intervention. Statute sets out the decisions which are for the independent regulator in each sector – and consequently which are not – and governments of all political shades have shown that they understand the value of independent decision-making which gives stability and confidence to regulated sectors.

As regulators we focus on the direction and consumer benefits from our own sectors. In producing this guide, we wanted to take a step back from the detail and to make sure we present a clear overview which is accessible to investors. We wanted to draw on the combination of our own understanding of the regimes we oversee with the expertise of a provider of advice to investors in these sectors. That is why we engaged KPMG to work with us on this, and they did an excellent job.

The cost of capital

The other project which I hope will be of particular interest is some work we are doing together on cost of capital.

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www.gov.uk/government/collections/national-infrastructure-plan

Many of the members of UKRN have to consider the level of appropriate returns on regulated assets. In many sectors the cost of capital figure, or the allowed return, is a single number that is very visible and important to regulated firms and investors, and as a result comes in for much scrutiny. We expend significant resource in developing our proposals in this area.

Much of this assessment is rightly sector-specific, reflecting the many differences between our sectors: the types of service offered, the way those services are priced, the importance or otherwise of network infrastructure, levels of investment, the extent and nature of competition, the attitudes and behaviour of consumers, and the way our economic regulation duties relate to our other objectives such as safety or various public interest goals, as well as differences in underlying market risk.

But there may be parts of this work that are more generic. And on these aspects in particular, it should be possible to learn from each other, drawing on our collective expertise and experience to ensure that each regulator's assessment is as effective as it can be. We should also be able to cooperate to ensure that we are communicating these assessments in a way which is as clear and transparent as possible to investors, thus ensuring that the cost of investment is kept as low as possible.

In order to do this we will, over the next year consider what mechanisms we could put in place to allow us effectively to pool our expertise. This is starting with a short factual summary of the outputs of recent work on cost of capital across our sectors. We will then ensure that each of us fully understands the approach that the others take; just this step should already allow us all to come to more effective decisions.

In case there is any doubt, this is absolutely not some kind of regulators' 'race to the bottom'. We will not be competing with each other on who can take the most aggressive approach to setting regulated returns.

Instead we see a 'win-win' for investors and consumers. The investment sums here are very large: as our guide indicates, more than £100bn across these sectors in the next five years. If we were able to improve investors' understanding of the way we establish allowed returns to such an extent that they required a return on investment that was even a handful of basis points lower, this would translate into significant savings on a consumer's annual bill.

We have started on this path with a short factual summary of cost of capital findings across our sectors, as well as making these findings as accessible as possible by creating a central depository on UKRN's website.[5] We have also established an ongoing cross-sector working group to maximise shared understanding. We are now moving forward to consider further ways of improving transparency and predictability across sectors; and as the work goes on will seek your views on ways of doing this.

Engagement between regulators and investors

For us, the investor guide and these initial steps on cost of capital represent the start of a process of engagement which we feel we need to have with investors on a more enduring basis. As I've said before, rather than simply coming together through price control processes, with the formation of UKRN there is an opportunity for a more sustained and consistent relationship. This should help both parties understand each other better.

As we move into UKRN's second year, we intend to engage more effectively with investors; we would like to understand your views on the role of regulation, and how it can work well for investors. And throughout, helping you to understand how we regulate to achieve our underlying goal: delivering the best outcomes for consumers.

Richard Price

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5 The depository will be part of the UKRN website at www.ukrn.org.uk