FSC FINANCIAL SERVICES COUNCIL

Public Infrastructure Inquiry
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 8003

Email: infrastructure@pc.gov.au

19 December 2013

Subject: FSC Submission to public infrastructure inquiry

Dear Commissioner Harris

The Financial Services Council (FSC) welcomes the opportunity to make a submission in relation to the inquiry into public infrastructure financing.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, private and public trustees. The FSC has over 130 members who are responsible for investing $2.2 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Superannuation funds and infrastructure financing

Superannuation funds are responsible for overseeing the investment of $1.75 trillion in capital for the sole purpose of providing benefits to fund members upon their retirement. This significant pool of capital clearly makes superannuation funds central to the debate around infrastructure financing.

In this context, the FSC commissioned EY to conduct a survey of the views of superannuation funds and investment managers towards the current tax and policy settings around infrastructure financing. EY's report is attached and details the outcome of these consultations and makes recommendations that are relevant to the Productivity Commission's inquiry.

Importantly, the report concludes that the current tax and policy settings for infrastructure financing are appropriate and that further regulatory change is unnecessary and may well be counterproductive. In the previous two years superannuation funds have participated in all five major asset sales by governments, thereby providing important capital for future government projects. Superannuation funds have also participated in an additional five PPP projects, assisting in the delivery of important greenfield projects.

It is understood that at present, approximately $50 billion is invested by superannuation funds in infrastructure assets. It is also forecast that significantly greater amounts of capital would become available should governments choose to continue moves to privatise public assets under the capital recycling model.

Stability of policy and tax settings

Superannuation funds will continue to be a reliable source of capital for infrastructure financing provided the investment environment is reliable. The EY research revealed that funds and investment managers consistently held the view that further regulatory and tax changes may be counter productive as it risks causing uncertainty in an asset class that requires stability to underpin long-term investment decisions.

Whilst this is particularly true in relation to short-term revenue measures, such as the previous Government's decision to increase withholding tax for Managed Investment Trusts without consulting with industry, it is also true for positive tax changes that may be viewed as unsustainable and likely to be 'wound back' by future governments.

The FSC recommends that state and federal governments commit to ongoing tax and policy certainty to reduce the risk incurred by superannuation funds when making long-term investment decisions.

Capital recycling

The report reveals that superannuation funds are strongly in favour of the capital recycling model as a method of delivering proven infrastructure assets to market for sale, which in turn 'frees up' capital for governments to invest in essential infrastructure projects.

EY particularly notes that infrastructure ownership is viewed by credit rating agencies as adding to balance sheet risk and often requires longer-term capital spending requirement putting pressure on the maintenance of government credit ratings.

The significant benefits to governments and funds should a "virtuous circle" be achieved whereby:

- superannuation investors would purchase brownfield assets at yields consistent with their established operating profile;
- governments could invest the proceeds in new 'greenfield' projects, avoiding the need to involve early expensive private funding; and
- eventually sell the greenfield infrastructure as a brownfield asset when the cash flow profile is stable.

The FSC recommends that state governments commit to a capital recycling model to provide certainty that a pipeline of projects will be available in which superannuation funds can invest.

Scale

The growth in the size of Australian superannuation funds is being seen to drive the capacity of funds to invest in infrastructure. The rationalisation of the industry has been considering, with the number of funds decreasing from over 4700 in 1996 to 352 in 2012. Primarily, larger funds are able to invest in large infrastructure assets without creating liquidity risk.

Further, the EY report reflected the fact that increasing scale has increased the number of funds with the critical mass to consider developing in-house infrastructure investment skills. Some participants additionally noted that investment managers were developing additional indirect infrastructure investment vehicles aimed at medium sized funds that could not justify the expense to create an in-house infrastructure team.

The FSC notes that the development of scale in the industry will be important in increasing the number of funds able to invest in infrastructure and the size of their infrastructure holdings. This will happen organically and could be accelerated by APRA as the superannuation prudential regulator.

Please feel free to contact me on 02 8235 2566 if you have any further questions or comments in relation to this submission.

Yours sincerely

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