Clean Energy Investor Group

50 Camberwell Road Hawthorn East VIC 3123

17 October 2022

The Honorable Stephen Jones MP
Minister for Financial Services
Commonwealth Government
Lodged by email to: YFYS@treasury.gov.au

Dear Minister,

Response to *Review of Your Future, Your Super Measures* Consultation paper
The Clean Energy Investor Group (CEIG) welcomes the opportunity to provide feedback on the Commonwealth Treasury (Treasury)'s *Review of Your Future, Your Super Measures* Consultation paper (the YFYS Consultation paper) published on 7 September 2022.

CEIG represents domestic and global renewable energy developers and investors, with more than 11GW of installed renewable energy capacity across more than 70 power stations and a combined portfolio value of around $24 billion. CEIG members' project pipeline is estimated to be more than 18GW. CEIG strongly advocates for an efficient transition to a clean energy system from the perspective of the stakeholders who will provide the low-cost capital needed to achieve it.

KEY POINTS

CEIG welcomes the Commonwealth Treasury's review of the YFYS measures, particularly around the performance test as its current settings could have unintended consequences on the cost of the Australian energy transition.

The current benchmark used for the performance test for unlisted infrastructure investments (MSCI Index) is not fit-for-purpose.

The use of the MSCI Index as the benchmark for the performance test is likely to have unintended negative consequences:

- The high benchmark return and risk profile could deter superannuation funds from investing in clean energy infrastructure assets;

- The high benchmark return and risk profile could also push superannuation funds to take greater risks to meet the benchmark return, unnecessarily attracting capital away from investment in infrastructure assets, to the detriment of superannuation members' long-term interests.

The unintended consequences from the use of the MSCI Index could negatively impact the cost of the Australian energy transition for electricity consumers.

- Over the next decade, superannuation funds have a significant opportunity and a critical role to play in providing low-cost capital to deliver the energy transition at least-cost for electricity consumers.

CEIG proposes to amend the unlisted infrastructure benchmark used for the performance test to:

- **exclude investments in clean energy assets** from the MSCI Index or from any other unlisted infrastructure index that might be developed as an alternative to the MSCI Index; and

- **adopt a benchmark return of 7.5% for investments in clean energy assets.**

CEIG welcomes the Commonwealth Treasury's review of the YFYS measures

CEIG welcomes the Commonwealth Treasury's decision to review the *Your Future, Your Super* (YFYS) measures to assess whether there have been any unintended consequences and implementation issues since the reforms came into operation in 2021.

CEIG is particularly focused on the review of the performance test, and we are concerned that the current settings of the performance test could have unintended consequences on the cost of the Australian energy transition: electricity consumers may be worse off if sufficient low-cost capital (including from superannuation funds) cannot be leveraged to finance the scale of infrastructure investment required in electricity generation and transmission assets, at the pace required.

Key concern: the current benchmark used for the performance test is not fit-for-purpose

In CEIG's opinion, the current benchmark used for the performance test - the MSCI Australia Quarterly Private Infrastructure Index (the MSCI Index) - is not fit-for-purpose.

The MSCI Index suffers from a number of drawbacks and uncertainties:

- The MSCI Index's definition of infrastructure is not clear;
- The composition of the MSCI Index is not aligned to historical unlisted infrastructure investment asset allocations:
  - For example, the MSCI Index appears under-weighted for renewable energy assets, assigning approximately 9% to renewable energy assets compared to 21% according to the InfraLogic Unlisted Infra Transactions since 2000 data[1], and over-weighted in transport assets, assigning 58% to transport (including Airports) compared to 27% according to the InfraLogic Unlisted Infra Transactions since 2000 data[2].
- It is not clear how many fund managers participate in the MSCI Index survey at any one time, and the number of participants can vary between surveys. Should a small number of fund managers participate, this could create a bias in the index.
- The application of Net Asset Value, as opposed to the median return, could further exacerbate the influence of a dominant fund or funds participating in the MSCI Index.
- Since it is not known how international assets are hedged in relation to their foreign currency exposure, there is no clarity around how net asset values are determined. This can create an asymmetrical understanding of underlying asset values; since more than 30% of asset values are in international currencies, this can have a material impact.
- The MSCI Index is unfrozen which generates a dynamic measurement of performance, and that measurement can include retrospective changes. This creates unnecessary uncertainty and complication.
- Finally, the participation of each fund manager is not weighted on the basis of the underlying emissions associated with their investments.

Those drawbacks create an unhelpful measurement of performance that works to elevate the return and risk profile that becomes the benchmark for the performance test. This is particularly true when combined with high inflation and high economic uncertainty and it is likely to push investment funds into taking greater risks to generate higher returns.

[1] Inframation Group
[2] Inframation Group

The use of the MSCI Index as the benchmark for the performance test is likely to have unintended consequences

The high benchmark return and risk profile inherent in the MSCI Index could deter superannuation funds from investing in clean energy infrastructure assets

The MSCI Infrastructure Index for Australian & International Unlisted Infrastructure currently sets a benchmark performance return (CAGR) of around 10% per annum. This benchmark return (CAGR) is in excess of historical returns on hedged international equity according to the MSCI International Equities (hedged) Index.

CEIG believes that seeking to achieve such a high benchmark return is not sustainable, particularly in the context of clean energy infrastructure investment.

By financing clean energy infrastructure assets, investors seek stable cashflows that generate long-term sustainable returns. Feedback from our Members suggests that, for unlisted contracted renewable energy infrastructure assets, seeking long-term financial returns in the order of 7%-8% per annum would be more consistent with historical returns and the risk profile for such assets and would create a more sustainable benchmark.

Retaining a 'higher than can be historically expected' benchmark for the performance test could deter superannuation funds from investing in clean energy infrastructure assets if that high performance cannot reasonably be attained through long term investment in those assets.

Superannuation funds will need to take greater risks to meet the benchmark return, at the detriment of superannuation members' long-term interests.

As this submission demonstrates, based on historical data, clean energy infrastructure assets are unlikely to generate long-term returns sufficient to match the MSCI Index.

For their portfolio to achieve the benchmark performance and pass the performance test, superannuation funds will then need to invest in more risky assets (or financial products) that can generate higher returns.

This could create perverse incentives that unnecessarily attract a large volume of capital away from investment in long-term infrastructure assets that deliver essential services to the Australian economy, to the detriment of superannuation members' long-term interests.

The unintended consequences from the use of the MSCI Index could negatively impact the cost of the Australian energy transition for electricity consumers

The total clean energy investment (generation, storage, and transmission network) required in the National Electricity Market to 2050 was recently quantified by the Australian Energy Market Operator in its *2022 Integrated System Plan* at around $320 billion (in net present value terms)[3].

CEIG is concerned that continuing to use the MSCI Index for the performance test could deter superannuation funds from investing in clean energy infrastructure assets.

For the Australian energy transition to be delivered at least-cost for electricity consumers, it is essential to source low-cost capital. Superannuation funds have a significant opportunity and a critical role to play in that regard over the next decade.

In August 2021, CEIG released its *CEIG Investor Principles - Unlocking low-cost capital for clean energy investment* Report[4] (the CEIG Investor Principles) which showed that significant savings in the cost of the energy transition can be made by accessing low-cost capital. Those savings were quantified to be up to $7 billion.

CEIG's alternative proposal

To remediate the negative consequences from the use of the MSCI Index, particularly in application to clean energy infrastructure assets, CEIG proposes a number of options.

Option 1 (preferred): exclude clean energy assets from the Index

The Commonwealth Treasury should:

- exclude investments in clean energy assets from the MSCI Index or from any other unlisted infrastructure index that might be developed as an alternative to the MSCI Index; and
- adopt a benchmark return of 7.5% for investments in clean energy assets in Australia.

<u>Option 2: use infra300 index</u>

The Commonwealth Treasury could replace the MSCI Index for the performance test with the infra300 index produced by EDHEC Infrastructure Institute, with investments in clean energy assets having a separate return profile in the Index.

[3] AEMO, *2022 Integrated System Plan* (Jun-22), available on the AEMO website.
[4] CEIG, *CEIG Investor Principles - Unlocking low-cost capital for clean energy investment* Report (Aug-21), available on the CEIG website.

The infra300 index includes significant benefits compared to the MSCI Index, including (but not limited to):

- the methodology to generate and report the infra300 index is robust;
- it is a reputable index, well understood and well used by industry;
- it has the potential for swift and timely implementation.

Option 3: create a new index

The Commonwealth Treasury could also:

- design a new, specific index for unlisted infrastructure (excluding investments in clean energy assets) using the infra300 index as a guide; and
- develop an Index specific to investments in clean energy assets.

CEIG understands this could deliver the most theoretically-sound, portfolio-representative index. However, because of the potential complexity and longer timeframes involved in building a new index, this is not CEIG's preferred option.

CEIG believes that Option 1 would be the most effective in encouraging and in facilitating responsible and long-term investment in clean energy assets.

CEIG thanks the Commonwealth Treasury for the opportunity to provide feedback on the YFYS Consultation paper and looks forward to continuing engagement on those issues.

If you would like to further discuss any elements of this submission, I can be contacted at marilyne.crestias@ceig.org.au.

Yours sincerely,

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