30 November 2023

Submission to the Industry & Regulators Committee for its inquiry into UK Regulators

Introduction

The Global Infrastructure Investor Association (GIIA) is the membership body for the world's leading institutional investors in infrastructure and advisors to the sector. Our members are responsible for more than £1.6tn of infrastructure assets under management across 70 countries. In the UK alone, our members manage assets in the water, energy, transport, and telecoms sectors totalling some £225bn, and serving some 51 million customers. This submission represents the views of GIIA, drawing on input from investors within our membership.

Throughout the past year, we have consistently called for regulatory reforms aimed at simplifying regulation and enhancing its effectiveness in promoting long-term infrastructure investment, which is vital for the country. The urgency for reform is supported by the results of our latest six-monthly pulse survey of GIIA members, published in November, which indicates a significant decline in the UK's appeal as an investment destination, to below the level of any other large, industrialised European country. The main deterrent for investment, as identified by our members, is the UK's 'unattractive regulatory regime' emphasising a dire need for action. (https://giia.net/insights/uk-must-make-ground-global-race-private-finance-infrastructure).

The UK is in a global race for private capital and we face stiff competition, especially from the large fiscal incentives offered to investors in the United States and the European Union. As the UK cannot match these offers, it must focus on improving the quality of its regulatory framework to remain competitive. Our members, who explore investment opportunities worldwide, express serious concerns that the UK needs to take decisive action to boost investor confidence.

Our Analysis

Historically, the UK's regulatory framework has been instrumental in driving substantial investments in regulated sectors, earning global recognition for its effectiveness. This approach has consistently delivered consumer benefits and fostered private sector investment, effectively complementing public sector capabilities. However, as the UK embarks on the substantial task of decarbonising its infrastructure to align with the 2050 Net Zero emissions goal, the role of regulators and their interaction with government policies becomes increasingly critical.

Research by PwC and GIIA indicates that the decarbonisation process will require an estimated £400 billion to be spent by 2030, marking a considerable increase from current investment levels. With government finances under pressure, the importance of private capital, bolstered by strong policy and regulatory frameworks, is paramount in transforming sectors such as energy, buildings, transport and digital infrastructure. This highlights the necessity for a regulatory environment that not only facilitates but actively promotes such transformative investments.

Recent trends in UK economic regulation, however, suggest a troubling shift towards prioritising short-term goals, often swayed by immediate political pressures. This shift comes at the detriment of long-term investment, as regulators neglect to account for the cost of inaction, essentially passing the burden onto future generations. Consequently, this change has injected a level of instability into the investment landscape precisely when stability is crucial.

A further concern is the heightened intervention by regulators in areas traditionally managed through corporate discretion, like financial structures. Interventions in these areas are unwarranted and dampen investment in the sector exactly when the government, investors and regulators should be working alongside each other to unlock the significant investment necessary to tackle the issues of climate change in a just and equitable way. Additionally, the potential damage to confidence is significant, as investors have historically relied on regulators refraining from interference in this aspect of their companies' structures, compelling them to factor in additional regulatory risks when considering capital deployment in the UK.

Regulators' interventionist stance is particularly noticeable in the water and energy sectors, where regulatory price determinations, such as Ofwat's PR19 determination, have started to adversely affect the perceived independence of regulators. Furthermore, the lack of consistency in cost of capital considerations across the regulators and the lack of formal precedential value of the CMA's decisions in this area does not help. It damages investors' ability to deploy the much-needed capital the country needs. These changes have collectively reduced the attractiveness of the UK to overseas investors, impacting sectors beyond utilities.

In view of these developments, it is crucial for the government to re-evaluate the equilibrium between regulator independence, long-term investment objectives, and short-term political factors. The review should aim to realign regulatory practices with the broader goals of sustainable economic growth, investor confidence, and a successful transition to a low-carbon economy. This entails re-examining regulatory frameworks to ensure they are suitable for long-term investments while retaining the flexibility to adjust to changing economic and environmental demands.

Recommendations for Change

1) Streamlining regulatory priorities to minimise complexity and avoid overlap between regulators by:

    a) *Revising the Strategic Policy Statements (SPSs) of regulators to include explicit priorities.*

    Following the recommendations put forward as part of the National Infrastructure Commission's 2nd National Infrastructure Assessment, there is a pressing need for clear and regularly updated Strategic Policy Statements to guide the strategic direction of regulators. The current SPSs for Ofwat and Ofgem are overly broad, failing to provide specific guidance for regulatory focus. This vagueness has led to the SPSs falling short of their objective to establish clear regulatory priorities. Additionally, an SPS for Ofcom is still pending and should be issued promptly to guide its regulatory approach.

    b) *Ensuring that regulators concentrate on their key priorities and avoid becoming excessively entangled in protracted administrative processes.*

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Through discussions with members and Ofwat, apprehensions have surfaced regarding the determination of the cost of capital. To alleviate the strain on Ofwat and mitigate the tension and intricacy involved in this procedure, a promising solution could involve making the CMA (Competition and Markets Authority) a mandatory consultee during regulators' WACC (Weighted Average Cost of Capital) calculation processes. By requiring the CMA to express an opinion on the WACC calculations, the government could ensure greater consistency across regulators. This would also serve to improve the accountability of regulators in creating the conditions necessary to incentivise investment.

c) *Aligning environmental standards across regulatory bodies to simplify compliance for investors and enhance regulatory efficiency.*

Investors have voiced significant concerns regarding inconsistencies in environmental standards set by different regulators. This disparity complicates environmental decision-making for investors and undermines the overall efficacy of regulatory processes. Through standardisation, it becomes easier for investors to navigate and comply with environmental regulations, thereby improving the effectiveness and coherence of regulatory oversight.

2. Strengthening accountability of regulators in promoting long-term infrastructure investment by:

a) *Mandating regulators to report on their effectiveness in attracting private investment into their respective sectors.*

Investors have noted that regulators often fall short in fulfilling their duty to encourage investment. Amid their myriad responsibilities, the imperative to foster investment tends to be overlooked, leading to insufficient investment for achieving shared infrastructure objectives. Requiring regulators to systematically report on their investment promotion efforts will enable the government to more effectively oversee their performance and ensure investment considerations are integral to their decision-making processes.

b) *Introducing transparent benchmarking systems to compare regulator performance in facilitating investments.*

A significant challenge is the lack of clear metrics to gauge and compare how effectively different regulators are promoting investment within their sectors. By implementing a transparent benchmarking system, it would be possible to measure and compare the performance of regulators in attracting and facilitating long-term investments. This approach would not only foster a culture of accountability but would also encourage healthy competition among regulators to improve their investment promotion strategies. Such benchmarking could include metrics like the volume of private investment attracted, the speed of project approvals, and the effectiveness of regulatory incentives in stimulating infrastructure development.

c) *Embedding long-term thinking into regulators' decision-making processes*

Embedding a long-term view into regulators' decisions is crucial for promoting sustained infrastructure investment, especially in the new greenfield projects the country desperately needs to reach its ambitious net-zero goals. Regulators should be mandated to establish clear and measurable long-term objectives. Utilising Strategic Policy Statements (SPSs) could serve as a mechanism to integrate and enforce this long-term focus, providing a framework for infrastructure investors who prioritise the development of sustainable and resilient projects over an extended time horizon.

In summary, we hope this submission highlights the need to review the regulatory framework, thereby allowing the UK to stand in better stead when competing for essential private capital. The recommendations we have put forward would help streamline regulatory priorities, strengthen accountability, and embed long-term thinking to foster the sustained infrastructure investment the country desperately needs.