

'FAKE INFRA' THREATENS REAL DEAL

By Frederic Blanc-Brude

| OCTOBER 16, 2017 |



Support for infrastructure investment, the idea that asset owners should commit to long-term capital projects through a mix of debt and equity, is a powerful notion at the heart of several important public and investment policy areas. It has been much discussed. It has become a staple of high-level G20 and European Union meetings. It has traveled from obscure trade publications to the mainstream financial press. It has practically become fashionable.

Infrastructure investment has also long been the preserve of large, sophisticated players, because it is complex and relatively expensive, but the many smaller pension plans and insurers increasingly find themselves unable to avoid the question: 'Why aren't we investing in infrastructure yet?'

Especially now. With listed infrastructure, suddenly anyone can invest in 'infra'. A liquid, easy-to-understand investment proposition offers to deliver all the benefits of private infrastructure investment without the hassle of locking up funds with a private manager or needing your own infrastructure deal team. Even your grandparents could do it. In fact, they do – or so they're told.

In a new Ecole des hautes Etudes Commerciales du Nord (EDHEC) position paper, we document the dangerous rise of the so-called listed infrastructure asset class, an ill-defined series of financial products that initially targeted retail investors and is increasingly used by institutional investors, which now represent close to a third of the market.

Promising to deliver the benefits of the infrastructure investment narrative, listed infrastructure has been growing by 15 per cent annually for a decade, reaching at least \$57 billion in assets under management (AUM) today.

But a review of published academic research shows that these products fail to deliver on their many promises. Listed infrastructure, as it is proposed to investors today, exhibits high drawdowns and volatility, does not have better risk-adjusted performance than broad market stock indices, and shows behaviour easily explained by a series of well-known factor tilts available to investors throughout the sharemarket.

The number of false claims made about this asset class is high enough to consider a mis-selling case, and in open letters to the United States Securities and Exchange Commission and the European Securities and Markets Authority, we recommend stricter regulatory oversight of these products, including the obligation to include the word 'listed' in their names to avoid misleading investors, along with the obligation to include information in marketing documents and information kits warning that listed infrastructure may not deliver the same performance as unlisted infrastructure investments.

For the new position paper, EDHEC reviewed the marketing documentation of 144

listed infrastructure products, representing 85 per cent of the sector by AUM, and concluded that such products typically make claims nearly identical to those of private infrastructure products.

We also performed new tests, extending existing research, that use the actual constituents of both passive and active listed infrastructure products, capturing most available listed investment products using the word 'infrastructure' in their name. We found even less convincing results than in previous studies, which relied on back-filled indices using data from a period when no listed infrastructure product even existed.

We found that active listed infrastructure managers have invested in close to 1900 different stocks over the last decade, half of which cannot possibly be considered infrastructure under any definition. They include brand names such as Amazon, Microsoft and Nintendo.

A growing shadow

The growth of listed infrastructure products is problematic because of the damage that their proliferation will eventually do to proper infrastructure investing.

We believe in the potential of infrastructure debt and equity investment for asset owners. We also see no reason why, in principle, some of the products used to access the characteristics of underlying infrastructure assets could not be listed on public markets.

But today's fake infra will disappoint. It is comparatively expensive (fees are higher than for other mutual funds) and will leave investors without the promised low-risk, stable, inflation-linked returns. As a result, it could give a bad name to infrastructure investing in general.

Fake infra could reverse years of investor education about the potential of infrastructure assets as sources of portfolio diversification and liability hedging. It could also undo recent progress in the prudential area towards recognising the existence of a specific risk-return profile and capital-charge treatment for infrastructure debt and equity.

It may even jeopardise the involvement of institutional investors in the next generation of public-private partnerships that have come to underpin so much of the national infrastructure plans most Organisation for Economic Co-operation and Development governments have put forward.

Eventually, sharemarket regulators should aim to achieve a clear definition of the listed infrastructure space, within which, listed infrastructure products that are better and more transparent could be created, with the aim of delivering at least some of the promises of infrastructure investment to asset owners.

Such a definition was developed in the context of the prudential regulation of insurers, pension plans and banks. Sharemarket regulators can use it to define which underlying assets would qualify to be included in listed equity products, as with other categories or groupings of stocks.

Furthermore, asset owners should require transparency and that listed infrastructure asset managers always publish their constituents; they should require valid evidence of listed products delivering on the narratives of infrastructure investment; and they should benchmark listed infrastructure products against unlisted ones.

We hope that those asset managers who are truly committed to infrastructure investment will support our call for clarity in the public-equity space, so that listed vehicles can be used to create products that genuinely offer new, rewarded risk exposures and help support the worthy goal of matching long-term capital with the infrastructure needs of the world.

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