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Discussion Paper: Measuring the Debt Risk Premium: A Bond Yield Approach
Economic Regulation Authority
PO Box 8469
Perth
WA 6849

By email: publicsubmissions@erawa.com.au

Dear sir or madam

Response to: Measuring the Debt Risk Premium: A Bond-Yield Approach

Brookfield and our submission

Brookfield Asset Management Inc. (Brookfield) is a global asset manager focussed on property, renewable power and infrastructure assets.

Brookfield has over 80 years of experience owning and operating utility and transport infrastructure. As assets that provide essential services, a large component of our infrastructure portfolio is subject to economic regulation. We currently own and operate assets in several international regulatory jurisdictions, including the UK, US, Chile, Australia and New Zealand.

The development of regulatory frameworks that are supportive to investment is of critical importance to Brookfield.

We welcome this opportunity to comment on the Discussion Paper: *Measuring the Debt Risk Premium: A Bond Yield Approach.*

A new approach is required

As an investor in two main gas pipeline systems regulated by the ERA – being the DBNGP and WAGAS - Brookfield notes that submissions have or will be made by these assets in so far as this Discussion Paper is intended to be used in the process for assessing revisions to the access arrangements for both systems. Brookfield notes that these submissions argue that it is not necessary to establish a debt risk premium for the purposes of assessing the rate of return under Rule 87 of the National Gas Rules. Brookfield supports these submissions.

However, to the extent that it is necessary, in the ERA's exercise of its statutory functions and powers, to establish a value for a debt risk premium, Brookfield recognises that a new approach to estimating the debt risk premium for regulatory purposes needs to be developed. Australian regulators have in the past relied on the estimates of 10-year fair yield curves derived by CBASpectrum and Bloomberg. Now CBASpectrum has ceased publishing its estimates and Bloomberg has progressively shortened the duration of its fair yield curves to below the 10-year time period used by Australian regulators.

The lack of market data being published by the current providers requires regulators to develop a new method for estimating the debt risk premium that is sustainable in the longer term. An approach that involves the development of a yield curve based on bond yields directly observed in the financial market is sensible. Such an approach is, in our view, likely to be widely supported, provided it is developed with full consultation of the industry and all stakeholders and is then applied in a fully transparent and consistent manner.

The change from using CBASpectrum and Bloomberg estimates to using directly observed current market pricing is a fundamental shift in methodology. It is a complex matter, which will have long-term and far reaching impact on investment and financing decisions. It requires consultation well beyond the very limited timeframe allowed for this Discussion Paper.

We understand that the short time period for this consultation is driven by the timing of the reset of the WA Gas Networks (WAGAS) and Dampier to Bunbury Pipeline (DBP) Access Arrangements. However, we would encourage the ERA to not accept and implement a hastily developed approach just to meet the timetable for making final decisions on these Access Arrangements. Neither should the final decisions be held up further to allow time for the development of a more considered approach.

In the interest of regulatory certainty, the ERA should select an approach for making these final decisions that is already well recognised and is as consistent as possible with that applied in previous regulatory decisions. The development of a new approach can then be conducted in a systematic way with sufficient time for meaningful consultation.

Bloomberg's fair yield curves

We propose that to the extent that the ERA is required, in the exercise or performance of its statutory powers or functions, to establish a value for a debt risk premium before this more detailed consultation is undertaken, it should continue to use estimates published by Bloomberg in a manner as consistent as practically possible with its previous approach.

We submit that this method is preferable for four important reasons:

- It is an approach that is as consistent as possible with the previously applied approach of using a combination of Bloomberg and CBASpectrum estimates. Consistency in regulatory decision making over time is one of the hallmarks of good regulation. Regulators that do not make fundamental shifts from previously applied methodologies without full and inclusive consultation build trust in the investor community and reduce the level of perceived regulatory risk.

- Bloomberg is an internationally recognised, independent source of reliable market information, trusted by the financial community.

- None of the alternative approaches mooted in the Discussion Paper provide a superior solution to using the Bloomberg estimates, nor do they provide a solution that is sustainable in the longer term. The Discussion Paper correctly points out the shortcomings of each of the AER, IPART and ACT approaches. The ERA's proposed solution, whilst admirably practical, does not fully address the complexity of the matter. All of these approaches are "quick-fixes" to what is a complex and critical part of the rate of return decision. Adopting a quick-fix, which represents a fundamental change in approach, without adequate consultation, would not constitute best-practice regulation.

- The use of Bloomberg estimates to finalise the WAGAS and DBP decisions, can be explicitly adopted as a short term measure, with the clear expectation that a more robust, long-term sustainable, approach will then be developed.

The ERA's intended approach

To the extent that is necessary to establish a debt risk premium, the ERA's intended approach is a move in the right direction towards a sustainable approach that relies on bond yields directly observed in the financial market. However, the approach as outlined in the Discussion Paper gives rise to a number of questions and issues that cannot be satisfactorily addressed in the limited scope and timeframe of this consultation. These issues include, but are not limited to:

- the selection of bonds for inclusion in the benchmark sample;
- the thin Australian bond market;
- the lack of liquidity in the corporate bond market; and
- the lack of comparable bonds in the regulated utility sector.

We expect that acceptable, practical solutions can be found for all of these issues in due course, but they are too complex and problematic to address within the current timeframe.

Conclusion

In summary we submit that the ERA should, to the extent that it is required to establish a value for a debt risk premium before more detailed consultation is undertaken, continue to use estimates published by Bloomberg in a manner as consistent as practically possible with its previous approach. Thereafter, the development of a new approach can be conducted in a systematic way with sufficient time for meaningful consultation.

If you have any questions, I will be pleased to elaborate further on any part of our submission. You can contact me on +612 9692 2823 or at adriaan.vanjaarsveldt@au.brookfield.com.

Yours faithfully,

Adriaan van Jaarsveldt
Senior Vice President, Regulation