Partnerships for a successful energy turnaround

Cooperation on both the supply and demand sides – The insurance industry offers equity and know-how

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Insurance companies look for reliable returns. But where can they find them? Ideas are needed; out-of-the-box ideas. Munich Re and Ergo's asset manager MEAG is treading new paths. It has already invested more than half a billion euros in Renewable Energies and New Technologies within its RENT investment programme. A large share of this amount has gone into onshore wind and photovoltaic power generation and electricity grids. These investments help take us closer to the energy turnaround that is a major objective of the German government. But MEAG isn't simply being altruistic; it is optimising its returns and profiting from greater diversification with RENT, and in doing so it is taking on additional social responsibility and helping the government achieve its goals.

Measured against the more than EUR 200 bn that MEAG manages for Munich Re and Ergo, an investment of half a billion in renewable energies is not all that much. A further EUR 2 bn are to follow in the near future, but only if the investments meet our demanding profitability criteria, taking the risks into account. A further EUR 1.5 bn are earmarked for investments in infrastructure, some of which bear relation to the energy turnaround. And the last word is far from having been spoken on the size of these investments. If the risk situation is okay, larger-scale investments are also attractive.

Core business remains unchanged

Partnerships are important for our investments for many reasons. Germany's insurance companies are key providers of capital to the German and European economies. With their investments in renewables and infrastructure, the insurers are not trying to compete with the energy economy at an operative level. The business of insurance companies remains insurance.

The insurance sector's investments in changing the way we produce and use energy are financial participations entered into with great care and prudence. One of the basic fundamentals of what we do is only taking risks we can gauge, and this applies in particular to how we invest. As the investor of Munich Re and Ergo's capital, we have the advantage that our parent company provides us with a lot of technical know-how in the field of insurance.

Mutual interests

We are confident about our partnership with the energy industry, for it is not only responsible operatively, it is also a key investor. This means that both the insurers and the energy companies share the same interests – we all want to see an adequate and reliable return on our investment.

A sustained partnership with the energy economy is vital for us, and the cooperation with the actuarial colleagues in the Group is a matter of course. But investors that don't dispose over technical know-how in the field of power plants should be wary. The technical and technological risks and the exposure to the risks of weather, climate change and natural disasters are major factors in the success or failure of a long-term investment.

Bundling small units

In its efforts to change its energy sector, Germany is focusing on decentralised power production close to the consumer. This tends to mean power generation plants that are often too small for investors like MEAG. But these small units are not only the result of political demand, they can also come about for technological reasons. Quite apart from the much-discussed ethical problems, the technology involved in generating energy from biomass simply favours small production units. But whatever the reasons for the smaller plants, it makes sense for a large investor to bundle them into investment packages. Partnerships in this field can be the key to further investments and help drive the energy turnaround forwards.

At the same time, large energy supply networks can be too big an investment even for MEAG. Partnerships on the demand side can be one solution. For example, MEAG recently acquired a stake in the consortium led by Macquarie Infrastructure and Real Assets (MIRA), which has reached an agreement with Eon to buy Open Grid Europe GmbH (OGE). MEAG's equity share is in the low three-digit euro millions. OGE owns and operates the longest regulated supra-regional natural gas transport network in Germany, with around 12,000 kilometres of pipeline and 27 compressor stations. OGE transports almost 62.5 billion cubic metres of natural gas every year – about 70% of the gas transport volume in Germany – and serves 450 customers. Consortia are also customary at an international level and can be beneficial when investors share similar goals.

Private investors are also essential

Everybody involved in the process agrees that the state does not have the means to finance the energy turnaround on its own. Against the background of stressed public coffers, the Public Private Partnership (PPP) model becomes more interesting. Indeed, with its heightened efficiency, the PPP is a legitimate tool even without considering the troubled government debt situation. Insurance companies are not only welcome as financial investors when it comes to supplying energy decentrally, they can also offer know-how and help share the risk. Alongside attractive returns, another factor important for private investors is that PPPs can mean shorter decision-making and permit processes and reduced bureaucratic obstacles. Furthermore, a stable control regime is important because a reliable framework is vital when making long-term investments.

Taking Solvency II into account

But not only the general investment conditions have to be clearly and reliably regulated for energy engagements, also over the long term. The insurance-specific criteria, which are substantially accounted for in Solvency II, also have to be covered, because more investments supporting the energy turnaround would be possible, but only if adequately recognised under Solvency II. As yet there is no capital requirement under the new supervisory regulations of Solvency II that is sufficient to cover the risks of investments in sustainable energy and infrastructure projects. At the moment, investments of this kind are considered together with other investment classes, and added to the quota for unlisted participations (e.g. hedge funds or private equity), although these involve much greater financial risks than investments in renewable energies and infrastructure with their very stable cash flows. If this inappropriate disadvantaging were eliminated, insurance companies could go even further in meeting their societal responsibilities and support the energy turnaround even more with long-term commitments. The energy turnaround requires considerable financial effort and society wants the investments it involves. For the political sector the mission is to create reliable framework conditions and eliminate obstacles to investment, while otherwise allowing the forces of the market economy to prevail. The political sector has most certainly not yet exhausted all its options, and neither has the market.

Markets still young

New markets have to find themselves and get organised, be they on the demand or the supply side. When investing in the energy turnaround, partnerships are indispensable from the insurance point of view. The insurance industry has predominantly equity to offer. It also has technical know-how, but operating power plants is certainly not its forte. Partnerships are advantageous here, both on the demand and the supply side. The energy turnaround desired and demanded by the government can be achieved if we join forces. The insurance industry will make a substantial contribution, especially with its long-term striving for good and sustainable investment returns.

Thomas Kabisch, MEAG CEO