Comments Template on EIOPA-CP-15-004 Consultation Paper on the Call for Advice from the European Commission on the identification and calibration of infrastructure investment risk categories		Deadline 09.August.2015 23:59 CET
Company name:	Association of British Insurers (ABI)	
Disclosure of comments:	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments on this CP should be treated as confidential, by deleting the word Public in the column to the right and by inserting the word Confidential.	Public
	Please follow the instructions for filling in the template: ⇨ Do **not** change the numbering in column "Reference". ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below. o If your comment refers to multiple paragraphs, please insert your comment at the first relevant paragraph and mention in your comment to which other paragraphs this also applies. o If your comment refers to sub-bullets/sub-paragraphs, please indicate this in the comment itself. **Please send the completed template to CP-15-004@eiopa.europa.eu, in MSWord Format, (our IT tool does not allow processing of any other formats).** The paragraph numbers below correspond to Consultation Paper No. EIOPA-CP-15-004.	
Reference	**Comment**	
General comments	The Association of British Insurers (ABI) welcomes the opportunity to respond to EIOPA's consultation on the Call for Advice from the European Commission on the identification and calibration of infrastructure investment risk categories. Before commenting on the consultation paper, we think it would be helpful to provide some background on the UK insurance industry and the ABI.	

The UK Insurance Industry

The UK insurance industry is the third largest in the world and the largest in Europe. It is a vital part of the UK economy, managing investments amounting to 25% of the UK's total net worth and contributing £10.4 billion in taxes to the UK Government. Employing around 320,000 people in the UK alone, the insurance industry is also one of this country's major exporters, with 26% of its net premium income coming from overseas business.

Insurance helps individuals and businesses protect themselves against the everyday risks they face, enabling people to own homes, travel overseas, provide for a financially secure future and run businesses. Insurance underpins a healthy and prosperous society, enabling businesses and individuals to thrive, safe in the knowledge that problems can be handled and risks carefully managed. Every day, our members pay out £148 million in benefits to pensioners and long-term savers as well as £58 million in general insurance claims.

The ABI

The Association of British Insurers is the leading trade association for insurers and providers of long term savings. Our 250 members include most household names and specialist providers who contribute £12 billion in taxes and manage investments of £1.8 trillion.

The ABI's role is to:

- Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
- Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
- Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
- Promote the benefits of insurance to the government, regulators, policy makers and the public.

Executive Summary

- Insurers are already investing in infrastructure, and could become an even more important source of funding as the long-term nature of insurance liabilities can be well-suited to the often long-term nature of infrastructure investment. It is imperative to develop a framework that will recognise and encompass the different risk categories for infrastructure investments in order to make such investments attractive to institutional investors. The ABI therefore welcomes EIOPA's consultation on the identification and calibration of infrastructure investment risk categories.

- We are broadly supportive of the infrastructure definitions proposed in the consultation, and acknowledge the challenges involved in developing this. We welcome the fact that EIOPA has opted for the more flexible approach to defining infrastructure, rather than attempting to create an exhaustive list of industries or project types. In our response, we propose some further improvements that could be made to the definition.

- We are also, on the whole, supportive of the headline requirements for infrastructure investment, and the additional requirements for unrated debt and equity. However, we find a number of the underlying criteria unduly limiting, and there is a risk that some criteria may unintentional leave jurisdictions or sectors completely out of scope. Our response identifies the elements of the requirements that we think would reduce the pool of potential infrastructure investment without being justified on prudential grounds.

- We are supportive of the proposed 30-39% band for infrastructure equity. However, we do not think that the proposed adjustments to infrastructure debt fully reflect the lower risk profiles of infrastructure investment and would continue to overstate the capital charges for this asset class.

	• Although we are disappointed EIOPA did not put forward a counterparty approach, we believe that an appropriate treatment of infrastructure investment could be achieved through a combination of liquidity and credit risk methodologies within the spread sub-module. • We appreciate the consultation is focussed on technical questions with regard to calibration, but in addition to looking at the capital charge under the standard formula, some guidance on treatment of infrastructure in internal models would be helpful. This could include exploring whether treatment should differ between projects where investing prior to construction vs investing into projects after construction phase finished, and whether the treatment should differ for (1) availability based projects versus volume based projects and (2) credit quality of users (for example, government departments compared to corporates). • Finally, we would like to thank EIOPA and the Commission for their work in this area. We stand ready to continue working together to build up the right regulatory and risk framework. If there is any aspect of our response that would benefit from clarification or elaboration, please do not hesitate to contact Julie Shah or Alisa Dolgova.	
Section 1.1.		
Section 1.2.		
Section 1.3.		
Section 1.4.		
Section 1.5.	The ABI believes that it is possible, and preferable, to combine the credit and liquidity approaches as suggested by EIOPA in paragraph 1.21. If, however, EIOPA decides to use only one of the above, the credit risk methodology is more	

	appropriate. This is because one of the distinguishing features of infrastructure debt is higher recovery rates (lower LGD), which results in lower credit risk as compared to corporate debt.	
Section 2.1.		
Section 2.2.		
Section 2.3.		
Section 2.3.1.		
Section 2.3.2.		
Section 2.3.3.		
Section 2.4.		
Section 2.4.1.		
Section 2.4.2.		
Section 2.5.		
Section 2.5.1.		
Section 2.5.2.		
Section 2.5.3.		
Section 3.1.	We believe that certain infrastructure corporates should fall within scope. Moody's report cited in Annex I found that infrastructure corporates have lower volatility and higher recovery rates compared to corporate bonds – this should be reflected in how they are treated. Including only infrastructure projects within the scope of eligibility would create an unlevel playing field between infrastructure projects funded through venture capital-type arrangements, who would qualify, and more 'traditional' infrastructure investment through corporate structures, which would not. We understand that EIOPA has a number of reservations about including corporates within scope. However, we do not think that the reasons set out in paragraph 1.52 are insurmountable. For	

	example: - As mentioned above, we do not believe that the available evidence points to infrastructure corporates and other corporates having the same risk profiles; - Only the portion of the corporate falling within the infrastructure investment definition as set out by EIOPA would qualify for the corresponding infrastructure investment treatment. We do not think that this creates problematic delineation issues, and would be similar to an infrastructure project potentially consisting of a mixture of eligible and ineligible elements as well; - It is not clear why it is relevant to assess the ease of infrastructure corporates' access to funding. It could also be argued that investment through infrastructure corporates could be improved further, either in terms of ease of access to funding or its terms. In any case, we do not think that corporates should be specifically discouraged from investing in infrastructure by disadvantaging them compared to those investing through infrastructure projects; - Infrastructure corporates are also a well-established format.	
Section 3.2.		
Section 3.2.1.		
Section 3.2.2.		
Section 3.2.3.		
Section 3.3.		
Section 3.3.1.	The ABI acknowledges that infrastructure investment is difficult to define, and appreciates EIOPA's work on this. We welcome that EIOPA has decided to set out a wider definition of infrastructure investment, rather limiting the scope to certain sectors. On the whole, we believe that EIOPA's definition provides a good framework, and would like to suggest a number of elements which could be refined further:	

- A number of elements are unclear or involve the use of subjective judgments. For example, what would qualify as an “essential service” or a “public service” is subject to interpretation, and the usefulness of the definition would depend on how it is applied in practice. Nevertheless, we acknowledge that an element of judgement is to a large extent unavoidable and has the upside of providing greater flexibility.
- The definition should refer to “facilities” as part of the definition alongside “physical structures, systems and networks”. This would remove the ambiguity as to whether investment into projects such as schools and hospitals qualify, as it is not clear whether they would be covered under “structures”.
- It is not clear why qualification is restricted to areas with limited competition. This is subjective and difficult to verify or implement in practice. It is also not evident why monopolies/oligopolies should be favoured as a matter of public policy. The requirement could exclude many projects that should otherwise be eligible - for example, it could be said that a proposed bridge across a river is subject to competition from a ferry service, even if no other means of crossing the river exists. Similarly, it could always be argued that a new hospital/ power plant etc. are competing against other such ventures, even when the public would benefit from an increase in capacity.
- It is unclear what is envisaged by “substantial” degree of control that lenders are required to have over the assets and income.

Paragraph 1.51: while we support the “public services” element of the definition, we disagree with EIOPA’s interpretation that this would always exclude from scope situations such as where a power plant provides electricity to a single factory – this would depend on the particular context/circumstances of the project.

As noted above, it is also not clear why only projects which would otherwise have problems attracting

	funding should be able to fall within the scope of eligibility. If we view the objective of the infrastructure definition and calibration work as ensuring that risk categories are appropriate for their underlying risk profiles, then similar risks should be treated in a similar way. If, however, we examine this from a public policy perspective of the types of projects that should be encouraged by policymakers, there is likewise no rationale for making the eligibility of an 'essential public services' project contingent upon its structural arrangement. Even if it is currently easier for corporates to access funding than for infrastructure projects, this is not a reason to penalise these as a matter of policy. We would also like to question the use of the term "lender" in the definition of "infrastructure project entity" in part a), as this term needs to encompass both equity and debt investors. The definition should either refer to "investors" or it read: "*in cases of infrastructure debt, the contractual arrangements give the lender a substantial degree of control over the assets and the income they generate*".	
Section 3.3.2.	While the objectives behind stress analysis, predictability of cash flows and contractual framework requirements are understandable, their translation into requirements is overly prescriptive and operationally burdensome. We set out the areas where we think the requirements are unnecessarily restrictive in our responses below. As an overarching comment, we would like to stress that requirements should apply at the point of investment.	
Section 3.3.2.1.	Stress testing We are generally supportive of the stress testing requirements proposed by EIOPA, and are pleased	

	to see that EIOPA notes that these should be used to the extent they are relevant based on the risks of the project.	
Section 3.3.2.2.	Predictability of cash flows While we are generally supportive of the predictability of cash flows requirement, we note this should allow for some variability, both in terms of revenue and expenses. EIOPA noted that is considering whether any requirements relating to the predictability of expenses are necessary. Cashflows are typically defined as inflows minus outflows, so we believe that expenses should be part of the consideration. The relevant measure should be the predictability of net cashflows available for investors (in the context of debt, this would be net cashflow available for debt service). 2. a) ii: this should encompass revenues subject to all types of regulation that set the price, not just rate-of-return regulation. 2. b) iii.: in cases where there is a single (non-government) off-taker, we believe it is too restrictive to limit eligibility to off-takers with an external rating. We suggest that internal ratings should also be allowed. We would also like to emphasise again that the assessment should apply at the point when the investment is made.	
Section 3.3.2.3.	Contractual requirements We are generally supportive of the requirement, but would like to highlight several areas where	

	improvements could be made: - 2: we would like to clarify the use of the term “lender” and whether this would still encompass both debt and equity investors, or whether it should be replaced with “investor”; - 2. d): we do not think that it is necessary to preclude all issuance of new debt. There are circumstances where the issuance of new debt may be desirable. For example, the requirement should allow for roll-over refinancing; e.g., in the case of the Australian PPP market, tenors are typically up to ten years, while the project lives are much longer. • Instead, the advice could either require lenders/investors to consent to new debt or for there to be contractual limitations on the issuance of new debt. - 2. e): it is not clear what it meant by the requirement that “all reserve funds have a longer than average coverage period”. We suggest that this should instead be in line with market practice. In addition, this can be funded by counterparties other than banks. We therefore propose the following alternative wording: *“All reserve funds have ~~a longer than average~~ coverage period* ***in line with market practice*** *and are fully funded in cash or letter of credit from a ~~bank~~* **counterparty** *of high credit standing*”.	
Section 3.3.3.	We support the requirement that rated debt should have a credit assessment of at least CQS 3.	
Section 3.3.4.	Many infrastructure projects are not externally rated, and it is important to get the treatment of unrated debt right. We understand and support EIOPA’s intention to ensure that unrated debt is of sufficiently high quality in order to qualify. While the categories of focus are sensible, the underlying requirements	

	are at times too prescriptive and even more stringent than those used by rating agencies. As a point of reference, we believe that the requirements for unrated debt should not go beyond those that apply to rated debt. This is particularly the case if EIOPA is not willing to differentiate between unrated debt corresponding to higher categories of ECAI ratings (i.e., above CQS 3). We identify in our responses below the key areas where we think improvements are possible.	
Section 3.3.4.1.	While the overarching intention of the requirement is understandable, we believe that a number of elements would be difficult to apply in practice and would unduly restrict the type of projects that may qualify. We would like to highlight the following elements of the draft advice: - 2. a): In addition to projects located in OECD and EEA countries, projects located elsewhere should also qualify, provided the political risks are adequately managed. - 2. b): The requirement that there be a low risk of specific changes to law, regulatory actions or the imposition of exceptional taxes may be challenging to prove in practice. Excluding from scope investments in countries with recent changes may run against the wider political objective, that the EU countries that would benefit the most from infrastructure investments are able to do so. - 2.c): Depending on how the requirement is interpreted, considering recent changes in regulation may potentially disqualify investment in projects located in most EEA jurisdictions.	
Section 3.3.4.2.	Structural requirements - 4. a): we are concerned that the requirement for the sponsor to have a "*very strong track record and relevant country and sector experience*" is unnecessarily restrictive. This would make it hard to support a sponsor's early ventures into a new market, even where they have relevant experience. For example, as currently drafted the requirement may exclude	

	investment into road building in Spain, where the sponsor has a record in building roads in France and Italy. • We would propose the following alternative requirement: "*… very strong track record and relevant experience*". - 4. b): the requirement for the sponsor to have "*high financial standing*" is also unnecessarily restrictive, and would disqualify many building contractors who are often unrated. In addition, we do not think that financial standing of a sponsor necessarily plays a decisive role in the overall risk profile of a project, and there are a number of other relevant considerations. For example, the credit quality of an investment can be enhanced through a stronger security package or other structural and financing arrangement.	
Section 3.3.4.3.	Financial risk The ABI believes that a requirement on amortising debt should not be part of the framework (as considered in para 1.104). There are projects with an element of non-amortising debt where a bullet repayment might be guaranteed or adequately covered and controlled well before the payment date. Point 6 of the advice requires the debt to have "the highest level of seniority at all time", we question if this is necessary.	
Section 3.3.4.4.	Construction risk While the construction risk criteria seem acceptable when considered individually, the cumulative effect is too prescriptive. For example, the requirement for a construction company to be "financially strong" is unclear and unnecessary. It is more important to consider whether, in case of failure, this	

	can be adequately managed and the construction company can be replaced if needed. In relation to requirement 2.d), technical and legal expertise need not necessarily be external. Requiring the insurer to have external advice goes too far in telling insurers how they should manage their risk, and seems to contravene the prudent person principle.	
Section 3.3.4.5.	Operating risk We have concerns around the requirement for material risks related to the operation of infrastructure assets to be transferred to an operating company. It is in practice common for the project to retain the risk budget for lifecycle works – and reserve appropriately – rather than have a fixed price contract with a lifecycle contractor. There are also instances where both the construction and the operation are carried out by the same company (for example, this is common in the case of airports). Similarly to the construction company scenario, we believe that requiring the operating company to have a "very strong track record" is also potentially restrictive and unnecessary.	
Section 3.3.4.6.	The ABI notes that a need to document "fully proven technology and design" would be problematic. This could limit investment and innovation relating to both new and existing technologies. For example, it is not clear whether a variation on an existing design would still meet the requirement, even in case of very established technology. In addition, these types of risks would be captured under the other requirements (for example, technological risk would impact the predictability of cash flows).	
Section 4.1.	The ABI believes that EIOPA should consider combining the credit and liquidity approaches within the spread sub-module. This would allow for the calibration to appropriately reflect the risk profile of infrastructure investment both in terms of its lower exposure to short-term fluctuations in liquidity	

	and better default and recovery rates.	
Section 4.2.		
Section 4.2.1.		
Section 4.2.2.		
Section 4.2.3.	The 60:40 split between credit and liquidity risk is derived from studies on corporate bond spreads (the majority of the studies were before the financial crisis during which the split has experienced significant regime change so 60:40 is not entirely convincing). However, infrastructure debts are highly illiquid and therefore a 60% credit component looks overly prudent.	
Section 4.2.4.		
Section 4.2.4.1.		
Section 4.2.4.2.		
Section 4.2.4.3.		
Section 4.2.4.4.		
Section 4.2.4.5.		
Section 4.2.5.	While we believe that the best option would be to combine liquidity and credit approaches, if only one is used we suggest that the credit approach is the more appropriate methodology.	
Section 4.2.5.1.	The ABI believes that adjustments to the credit risk module should not be restricted to CQS 2 and 3, and should be applied to higher credit quality classes as well.	
Section 4.2.5.2.		
Section 4.2.5.3.		

Section 4.2.5.4.		
Section 4.3.		
Section 4.3.1.		
Section 4.3.2.		
Section 5.1.	Counterparty default risk module We are disappointed that EIOPA is not considering the counterparty approach, which has a number of advantages such as being neutral on maturity/duration of the debt. In addition, infrastructure debts would have provided further diversification benefits (default SCR and market risk SCR are 25% correlated under SF) rather than just being added to the spread module under market risk SCR.	
Section 5.2.		
Section 5.3.		
Section 6.1.	Equity calibration The ABI is supportive of the proposed calibrations resulting in a stress of between 30% and 39% for infrastructure equity investments. However, we recognise that the equity calibration takes a simplistic approach to model infrastructure equities as a sub-sector in a well-diversified equity index (i.e. similar treatment to sectoral equity indices). We would suggest that a full look-through approach could also be considered for infrastructure equities (or alternatively, a % value stress for the underlying infrastructure assets) for the following reasons: - It is in line with the look-through principle in Article 84 (directive 2009/138/EC), particularly	

	when the infrastructure investment is structured as funds; - The three proxies considered by EIOPA failed to recognise that leverage plays an important role when comparing equity performances/VaRs: for example the degree of leverage of the PFI portfolio could be materially different to that of the wider FTSE all index; - Therefore, applying 30-39% shock to all infrastructure equities severely penalises equity investment in unleveraged infrastructures; and provides the wrong incentive. We have some reservations with the consultation's contention that business decisions are limited in scope as the owner has full control over the project.	
Section 6.2.		
Section 6.2.1.		
Section 6.2.2.		
Section 6.2.3.		
Section 6.3.	The ABI is supportive of the proposed calibrations resulting in a stress of between 30% and 39% for infrastructure equity investments. The proposed band will encompass the different types of projects with varying risk and cash flow profiles (e.g. greenfield and brownfield infrastructure projects).	
Section 7.1.		
Section 7.2.		
Section 7.3.	We do not think that it is necessary to prescribe elements of risk management. The prudent person principle is the currently best practice in any case, and it is not clear why it is necessary to legislate for best practice, as this would just prevent future improvements.	

	We agree that insurers need to understand the risks that they are exposed to, and this is a routine part of managing an insurance business. However, we do not think that infrastructure investment can or should be treated in all cased as a "non-routine investment activity" (paragraph 1.208).	
Section 8.	Guarantees by a RGLA should be treated in the same way as other government guarantees. This would be consistent with the same treatment afforded to central government and RGLA exposures. (1.221). We note that insurers would still be expected to understand the risks associated with the project.	
Annex I		
Annex II		
Annex III Sections:		
Section 1.		
Section 2.		
Section 2.1.		
Section 2.2.		
Section 2.3.		
Section 3.		
Section 3.1.		
Section 3.2.		
Section 3.2.1.		
Section 3.2.2.		
Section 4.		
Section 4.1.		
Section 4.2.		

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Section 4.3.		
Section 4.4.		
Section 4.5.		
Section 5.		
Annex IV		
Annex V		