	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
Name of Company:	European Private Equity & Venture Capital Association	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-12-003@eiopa.europa.eu. Our IT tool does not allow processing of any other formats.** The numbering of the paragraphs refers to Consultation Paper 12-003.	
Reference	**Comment**	
General Comment	The European Private Equity and Venture Capital Association (EVCA) welcomes the opportunity to comment on the Draft Technical Specifications for the quantitative impact study (QIS) of EIOPA's advice to the European Commission on the review of the IORP Directive. The EVCA will focus its comments on this consultation on the areas of key relevance relating to the private equity and venture capital industry. The EVCA welcomes the fact that a quantitative impact study is to be conducted before any revision is proposed.	

Much of the EVCA's comments, particular on the market consistent approach and SCR, are based on a Research paper ""Calibration of Risk and Correlation in Private Equity"[1] supplied to the Solvency II team at EIOPA on May 20th . The EVCA recommends that EIOPA review this paper both in the context of risk calibrations under Solvency II, and the context of developing this QIS and any wider review of the IORP Directive.

As a result of the EVCA's findings in this paper we recommend that investments in private equity funds are treated in a single, and separate, sub-module within the market risk category of the SCR.

The EVCA, also has concerns over the scope, timing and coverage of the quantitative impact survey:

- A large part of the QIS consultation has been copy-pasted from the Solvency II Directive, in particular the Solvency Capital Requirement, and the associated classification of asset classes and their subsequent risk weightings. This is despite assurances from the European Commission that there will be no copy and paste of Solvency II for IORPs.[2]
- The use of Solvency II, designed for the insurance industry, is not reasonable as an IORP has a much longer risk horizon. This longer risk horizon requires other risk measurement and calculations. Illiquidity should play a much less prominent role. Diversification effects, which may be present in particular among alternative investments such as private equity, real estate, and infrastructure needs to be modeled much more carefully. Assuming the same or even zero return expectations is unreasonable for a long risk horizon and implies

[1] Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity

[2]Commissioner Barnier (1/03/12) Public hearing on the revision of the Directive on occupational pensions

	a discrimination against long term, illiquid asset classes such as private equity. Such treatment might avoid investment in such assets the returns of which are much needed in a low interest rate environment to fund long term liabilities. In addition the provision of such long term capital is a clear requirement for Europe to overcome its deep economic crisis. ▪ The use of the Solvency II SCR also implies a repeat of inappropriate data and methods of calibration.[3] ▪ Where the specificities of pension funds have been taken into account (i.e. not directly inspired by Solvency II) further analysis is required as these are not detailed enough in the current consultation. ▪ The EVCA has concerns about the feasibility of The Holistic Balance Sheet (HBS) as a tool for pension fund supervision, as it is based on many subjective assumptions and will be extremely costly and complex for IORPs to set up and manage. This will be to the detriment of pension plan members and not achieve its goal of making pension schemes comparable. ▪ This QIS is very detailed and the timeframe very short. This makes it very difficult for individual IORPs to provide responses to this consultation. IORPs will be subject to any revised Directive and as such should have the opportunity to study the technical specifications and submit their reactions.	

[3] Mittnik(2011) Solvency II Calibrations: Where Curiosity Meets Spuriosity

	▪ Only eight member states will participate in the QIS, raising concerns over the legitimacy and the extent to which the QIS is representative. In addition in some member states only supervisors will respond, rather than the individual IORPs who will be subject to any revised Directive. The overall market-risk approach for private equity and venture capital represents a fundamental misunderstanding of the risk faced by an institutional investor in private equity. The EVCA wishes to point to the adverse impacts of this approach on economic growth and long-term investment, by reducing investment in non-listed companies, in particular small- and medium-sized companies, the backbone of the European economy. Pension funds invest in the private equity and venture capital asset class as the characteristics of such investments corresponds well with their long-term investment horizon and meets their interest to invest in an asset class of substantially different characteristics compared to listed equities and bonds. Private equity funds, which operate over at least a ten year period, have for many years been trusted by many of Europe's largest stewards of current and future pensioner's income as a source of stable, strong, risk adjusted returns. This explains why, in the period from 2006 - 2010, pension funds accounted for over 36% of all funds raised by the European private equity industry. As well as delivering strong returns to pension funds - critical for defined benefit funds to be able to meet their pension liabilities as they fall due - private equity also provides the long-term investment needed to deliver growth in the real economy. It is this long-term growth, sustained by long-term capital, that provides a foundation for job creation, investment and tax revenues. Over the past four years, European pension funds have invested €53bn, via private equity, in European companies. A total of 83% of private equity backed companies are small to medium sized enterprises ("SMEs"), which constitute the backbone of the European economy.	

	[1] Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity [2]Commissioner Barnier (1/03/12) Public hearing on the revision of the Directive on occupational pensions [3]Mittnik(2011) Solvency II Calibrations: Where Curiosity Meets Spuriosity	
Q1.	The EVCA understands that technical issues that would normally be specified in Level 2 implementing measures, such as the risks to be included in the calibration of the SCR, and their accompanying stresses and correlations in the standard formula, should be included if a Solvency II like SCR is to be calculated. However EVCA remains unconvinced of such an approach for pension funds. In order to calculate any theoretical risk calibration and correlations for private equity and venture capital, the full specificitiesof measuring risk in the asset class should be taken into consideration in order to produce a risk calibration and correlations that are appropriate. These specificities together with an appropriate database and calibration methodologies are expanded upon in this document in our comments on SCR 5.28, 5.29, 5.33, 5.35 and 5.38 and explained in detail in the EVCA Research Paper "Calibration of Risk and Correlations in Private Equity"[4] presented to EIOPA on May 20th 2012. This EVCA Research Paper demonstrates, depending on the calibration method and the data base used, the shocks for the asset class, and hence the standard risk weighting for private equity, are between 20% and 35%. In addition to an appropriate risk calibration and correlation the specific characteristics of the asset class should also be taken into consideration when classifying private equity and venture	

[4]Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"

capital within the market risk sub-module. These characteristics include:

- PE funds typically make long-term, one hundred per cent equity backed, investments
- PE funds do not offer redemption rights for investors
- PE funds do not use leverage at fund level, i.e. they are not exposed at fund level
- PE funds do not engage in credit origination activities.

Against the background of these characteristics of private equity and venture capital funds a fund structure has developed that may be defined as follows:

> "Private equity and venture capital funds are unleveraged funds which predominantly invest in equity instruments and instruments that are economically similar to equity instruments issued by unlisted companies.
>
> Such funds are characterised by alignment of interest through sharing of risk between management and investors. They are generally only open to eligible investors, namely professional clients and certain sophisticated HNWIs, and do not provide redemption rights to investors for a period of at least five years after the first closing of the fund, i.e. the date when the first investor is admitted to the fund.
>
> Private equity and venture capital funds of funds invest in private equity and venture capital funds as defined above."[5]

Consequently, we recommend creating a private equity and venture capital sub-module to accurately reflect the standard risk weighting for investing in private equity and venture capital

[5] EVCA Position Paper (2012) "What is a private equity and venture capital fund?"

	funds and the unique characteristics of private equity and venture capital funds. [4]Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity" [5]EVCA Position Paper (2012) "What is a private equity and venture capital fund?"	
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I.3.2.	The EVCA understands the fact that the QIS is confined to numerical calculations. It is therefore important to underline where the technical specifications chosen by EIOPA are inappropriate. The EVCA rejects the proposal of a holistic balance sheet when it is used for supervision. The idea of a holistic balance sheet seems to offer theoretical possibilities for taking into account the risk mitigating instruments that an IORP has, but the complexities involved make this an instrument that is unsuitable as a primary supervision tool. Besides that, it is important to realise that workplace pensions are based on social and cultural traditions and strongly linked to first pillar pension provisions in the different Member States.	
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I.4.5.	The EVCA's key concern is that the potential application of the Solvency II regime to IORPS would be inappropriate and disproportionate. It could affect pension funds' investment strategies resulting in a number of negative consequences for pension funds and their members and the wider economy. Where the specificities of pension funds have been taken into account (i.e. not directly inspired by Solvency II) further analysis is required as these are not detailed enough in the current consultation. The EVCA has concerns about the feasibility of The Holistic Balance Sheet (HBS) as a tool for pension fund supervision, as it is based on many subjective assumptions and will be extremely costly and complex for IORPs to set up and manage. This will be to the detriment of pension plan members and not achieve its goal of making pension schemes comparable.	
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I.4.18.	In order to calculate any theoretical risk calibration and correlations for private equity and venture capital, the full specificitiesof measuring risk in the asset class should be taken into consideration in order to produce a risk calibration and correlations that are appropriate. These specificities together with an appropriate database and calibration methodologies are expanded upon in this document in our comments on SCR 5.28, 5.29, 5.33, 5.38 and explained in detail in the EVCA Research Paper "Calibration of Risk and Correlations in Private Equity"[6] presented to EIOPA on May 20th 2012. This EVCA Research Paper demonstrates, depending on the calibration method and the data base used, the shocks for the asset class, and hence the standard risk weighting for private equity, are between 20% and 35%. In addition to an appropriate risk calibration and correlation the specific characteristics of the asset class should also be taken into consideration when classifying private equity and venture capital within the market risk sub-module. These characteristics include: • PE funds typically make long-term, one hundred per cent equity backed, investments; • PE funds do not offer redemption rights for investors; • PE funds do not use leverage at fund level, i.e. they are not exposed at fund level; • PE funds do not engage in credit origination activities.	

[6]Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"

	Against the background of these characteristics of private equity and venture capital funds a fund structure has developed that may be defined as follows: "Private equity and venture capital funds are unleveraged funds which predominantly invest in equity instruments and instruments that are economically similar to equity instruments issued by unlisted companies. Such funds are characterised by alignment of interest through sharing of risk between management and investors. They are generally only open to eligible investors, namely professional clients and certain sophisticated HNWIs, and do not provide redemption rights to investors for a period of at least five years after the first closing of the fund, i.e. the date when the first investor is admitted to the fund. Private equity and venture capital funds of funds invest in private equity and venture capital funds as defined above."[7] Consequently, we recommend creating a private equity and venture capital sub-module to accurately reflect the standard risk weighting for investing in private equity and venture capital funds and the unique characteristics of private equity and venture capital funds. [6]Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity" [7]EVCA Position Paper (2012) "What is a private equity and venture capital fund?"	
I.4.19.	The EVCA welcomes that EIOPA will report on other possible confidence levels, however the EVCA	

[7]EVCA Position Paper (2012) "What is a private equity and venture capital fund?"

	does not believe that it is possible to give a single, universal, confidence level for all European occupational pensions schemes. Confidence levels and discount rates are also closely tied to specific plan designs. We believe that Member States should have the flexibility they need to adapt these mechanisms to their diverse industrial relations systems. In addition and given the long risk horizons of IORPs the EVCA believes it is more important to analyse the impact of: ▪ Risk horizons longer than one year ▪ The impact of different return expectations, which are much more important for longer risk horizons ▪ Different methods to treat dependencies, especially among alternative investments such as private equity , hedge funds, real estate and other financial assets and risk areas ▪ More appropriate data and methods for calibration as outlined in the EVCA research paper and other work such as the study by Professor Mittnik (2011)[8] 8 Chakravarty/Diller (2012) EVCA Research Paper:"Calibration of Risk and Correlation in Private Equity" Mittnik(2011) Solvency II Calibrations: Where Curiosity Meets Spuriosity	
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[8] Chakravarty/Diller (2012) EVCA Research Paper:"Calibration of Risk and Correlation in Private Equity"
Mittnik(2011) Solvency II Calibrations: Where Curiosity Meets Spuriosity

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HBS.9.1.	EVCA agrees with EIOPA that assets should be valued on a market consistent basis. However, EVCA stresses that a market-consistent basis should not be limited to "mark-to-market" valuation as this will not always be appropriate. IORPs are long-term investors and their long-term investment horizon means they are able to invest in more illiquid growth assets such as private equity investments. For investments in illiquid assets, mark-to-market valuations are not always possible, or even meaningful. Therefore, EVCA urges EIOPA to expressly recognise that market consistent valuations encompass the "fair value" valuation methods consistently applied in the private equity fund sector and laid out in the International Private Equity Valuation (IPEV) guidelines in order for such valuation methods not to be detrimental to the financing of European non-listed companies.	
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SCR.1.11.	The EVCA rejects this starting point as fundamentally flawed. The consequence of the 99.5% confidence level over a one year period in Solvency II has been to exacerbate volatility for insurance firms while putting much of the focus on the liquidity of investments rather than the capital at risk. The much longer risk horizon for IORPs makes certain aspects of the SII calibration unreasonable or inconsistent because: ▪ The one year risk horizon is too short ▪ There is a disproportionate capital charge for certain illiquid assets ▪ It largely ignores the diversification effects of alternative investments, such as private equity, real estate, hedge funds and others, as well as the diversification benefits between alternative assets and other assets and risks ▪ The use of inappropriate data and methods for calibration of risk charges[9] In addition most investors in private equity focus on the long-term cash flow behaviour of the	

[9] Mittnik(2011) Solvency II Calibrations: Where Curiosity Meets Spuriosity

asset class and are not overly concerned with the quarterly changes of the valuations during the lifetime of the fund. This is because for investors the true economic value of the unquoted investments is only known upon realization of those investments. Investors in private equity are generally characterized by having a long-term investment horizon, so focus on the long-term return potential of a private equity fund commitment, while taking into consideration the loss risk of such an investment. Pension funds are a good example of the sort of typical investor that has a very long-term investment horizon. A pension fund is well-placed to bear the illiquid nature of private equity, as part of a balanced and diversified investment strategy. Moreover, exposure to private equity by such an investor will be gained through a diversified portfolio of private equity funds.

In a recent research paper supplied to EIOPA[10], EVCA presents an approach that fully captures the risk and return profile of investing in a portfolio of private equity funds distinguishing the three main risks In private equity:

- **Liquidity and funding risk:** the risk that the investor cannot meet its obligations to pay draw downs on a commitment as they fall due.

- **Long-Term default risk:** the risk that the investor loses capital with its private equity investment over the entire lifetime of the product ("Hold to maturity"). Hence interim valuations do not really play a role, they only provide an indication of what the final and true value of the investment may be. Long term risk can be expressed through the ratio between capital returned and capital paid-in. Until the investor has received back its full capital drawn down it runs some risk of losing part of its capital.

- **Short-term valuation changes (risk)** is the risk that the value (NAV) changes over time.

[10] Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"

	These values are mark-to-market, or often in the case of private equity, mark-to-model accounting values and not market values in the traditional sense used in public equity investing. By definition the underlying investments are not traded on any market, hence there is no real market value. Interim valuations and movements in the stated NAV can, however, play a role in the balance sheet of some institutional investors, such as banks. We believe that it is entirely compatible with a market consistent approach to capture the full value at risk of investments in a portfolio of private equity funds. [9]Mittnik(2011) Solvency II Calibrations: Where Curiosity Meets Spuriosity 10Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"	
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SCR.5.1.	EVCA stresses that a market-consistent examination of risk should not be limited to "mark-to-market" valuation as this will not always be appropriate. IORPs are long-term investors and their long-term investment horizon means they are able to invest in more illiquid growth assets such as private equity investments. For such investments mark-to-market valuations are not always possible, nor event meaningful. Therefore, EVCA urges EIOPA to expressly recognise that market	

	consistent valuations encompass the "fair value" valuation methods consistently applied in the private equity fund sector and laid down in the International Private Equity Valuation (IPEV) guidelines in order for such valuation methods not to be detrimental to the financing of European non-listed companies. For investors in private equity the risk is not about the volatility of market prices as the concept of a market price for unmarketable assets is not logical. Most investors in private equity focus on the long-term cash flow behaviour of the asset class and are not overly concerned with the quarterly changes of the valuations during the lifetime of the fund. This is because for investors the true economic value of the unquoted investments is only known upon realization of those investments. Investors in private equity are generally characterized by having a long-term investment horizon, so focus on the long-term return potential of a private equity fund commitment, while taking into consideration the loss risk of such an investment. Pension funds are a good example of the sort of typical investor that has a very long-term investment horizon. A pension fund is well-placed to bear the illiquid nature of private equity, as part of a balanced and diversified investment strategy. Moreover, exposure to private equity by such an investor will be gained through a diversified portfolio of private equity funds. In a recent EVCA research paper supplied to EIOPA[11], EVCA presents an approach that fully captures the risk and return profile of investing in a portfolio of private equity funds distinguishing the three main risks In private equity: • **Liquidity and funding risk:** the risk that the investor cannot meet its obligations to pay draw downs on a commitment as they fall due.	

[11] Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"

	• **Long-Term default risk:** the risk that the investor loses capital with its private equity investment over the entire lifetime of the product ("Hold to maturity"). Hence interim valuations do not really play a role, they only provide an indication of what the final and true value of the investment may be. Long term risk can be expressed through the ratio between capital returned and capital paid-in. Until the investor has received back its full capital drawn down it runs some risk of losing part of its capital. • **Short-term valuation changes (risk)** is the risk that the value (NAV) changes over time. These values are mark-to-market, or often in the case of private equity, mark-to-model accounting values and not market values in the traditional sense used in public equity investing. By definition the underlying investments are not traded on any market, hence there is no real market value. Interim valuations and movements in the stated NAV can, however, play a role in the balance sheet of some institutional investors, such as banks. We believe that it is entirely compatible with a market consistent approach to capture the full value at risk of investments in a portfolio of private equity funds. _____ [11]Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"	
SCR.5.2.		
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SCR.5.4.	The EVCA believes that these correlations are very conservative for alternative investments which are often called "alternative" because they are subject to low correlations between themselves and with other assets and risk areas. Current calibrations in Solvency II do not account for this. Such oversights should not be repeated, particularly within the longer term risk framework	

	applying to IORPs, which will serve to enforce the onerous impact of such inacurracies. IORP's should be incentivised to use higher yielding and less dependent investments especially in the low interest rate, low growth and high volatility environments expected to prevail in the foreseeable future, especially in Europe. This will be the only way IORPs, and in turn society, will be able to fund reasonable pensions in an affordable manner.	
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SCR.5.11.	The look through approach should be applied to funds of private equity funds but it should not go beyond the level of a private equity fund making direct investments into unlisted companies.	
SCR. 5.12.		
SCR. 5.13.		
SCR.5.14.	This approach assumes an investment is in a single private equity fund. Investment activity of pension funds is always based on investing in a portfolio of funds diversified by investment stages, geographies and vintage years. This leads to a considerably lower risk profile of the portfolio as a whole compared to that of each single fund. In addition each fund benefits from diversification benefits from investing in a number of individual, unlisted companies (perhaps twenty or more companies and typically no fewer than eight companies). In addition there is no cross-collateralisation between the assets of different portfolio companies. This means that even in the case of a default investment in a single company by a private equity fund, there is no impact on the other investments of the private equity fund. As previously stated pension funds diversify their investments across a number of PE funds, and in turn potentially thousands of underlying portfolio companies.	

	Many studies have shown evidence that a diversified portfolio of private equity funds has a relatively low risk. One of the most important studies in this area from Weidig / Mathonet (2004) shows that a portfolio with more than 20 funds has extremely limited risks (i.e. zero risk) with a confidence level of 99% of losing any capital over the entire lifetime of the portfolio. A study from Diller / Herger shows that a well-diversified portfolio of 25 funds spread over 5 years will end up with a similar result. Meyer / Mathonet (2005) also show that a portfolio with more than 20 funds is considered as being well-diversified. It is therefore not appropriate to apply this look through approach to private equity and venture capital funds. Because of the above and the factors outlined in our comments on SCR 5.28, 5.29, 5.33, 5.38 private equity and venture capital should be in its own sub-group with an appropriate risk calibration.	
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SCR.5.28.	For investors in private equity the risk is not about the volatility of market prices as the concept of a market price for unmarketable assets is not logical. Institutional investing in private equity is predominantly through unlisted funds that have a contractual lifetime of 10 years and follow a very distinct lifecycle. In such cases it is meaningless to view risk as the volatility of a time series over short horizons. In order to correctly capture the risk of investing in private equity funds the following factors should be taken into consideration: • **Liquidity and funding risk:** the risk that the investor cannot meet its obligations to pay draw downs on a commitment as they fall due. • **Long-Term default risk:** the risk that the investor loses capital with its private equity investment over the entire lifetime of the product ("Hold to maturity"). Hence interim valuations do not really play a role, they only provide an indication of what the final and true value of the investment may be. Long term risk can be expressed through the ratio between capital returned and capital paid-in. Until the investor has received back its full capital drawn down it runs some risk of losing part of its capital. • **Short-term valuation changes (risk)** is the risk that the value (NAV) changes over time. These values are mark-to-market, or often in the case of private equity, mark-to-model accounting values and not market values in the traditional sense used in public equity investing. By definition the underlying investments are not traded on any market, hence there is no real market value. Interim valuations and movements in the stated NAV can, however, play a role in the balance sheet of some institutional investors, such as banks.	

SCR.5.29		
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SCR.5.31		
SCR.5.32		
SCR.5.33.	Investors in private equity funds are not exposed to market volatility and as such it is entirely appropriate for private equity to be classified in third and separate sub-group. In order to calculate any theoretical risk calibration and correlations for private equity and venture capital, the full specificities of measuring risk in the asset class should be taken into consideration in order to produce a risk calibration and correlations that are appropriate. These specificities together with an appropriate database and calibration methodologies are explained in detail in the EVCA Research Paper "Calibration of Risk and Correlations in Private Equity"[12] presented to EIOPA on May 20th 2012. This EVCA Research Paper demonstrates depending on the calibration method and the data base used, the shocks for the asset class, and hence the standard risk weighting for private equity, are between 20% and 35%. In addition to an appropriate risk calibration and correlation the specific characteristics of the asset class should also be taken into consideration when classifying private equity and venture capital within the market risk sub-module. These characteristics include: ▪ PE funds typically make long-term, one hundred per cent equity backed, investments; ▪ PE funds do not offer redemption rights for investors;	

[12] Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"

- PE funds do not use leverage at fund level, i.e. they are not exposed at fund level;
- PE funds do not engage in credit origination activities.

Against the background of these characteristics of private equity and venture capital funds a fund structure has developed that may be defined as follows:

> "Private equity and venture capital funds are unleveraged funds which predominantly invest in equity instruments and instruments that are economically similar to equity instruments issued by unlisted companies.
>
> Such funds are characterised by alignment of interest through sharing of risk between management and investors. They are generally only open to eligible investors, namely professional clients and certain sophisticated HNWIs, and do not provide redemption rights to investors for a period of at least five years after the first closing of the fund, i.e. the date when the first investor is admitted to the fund.
>
> Private equity and venture capital funds of funds invest in private equity and venture capital funds as defined above."[13]

In addition many studies have shown evidence that a diversified portfolio of private equity funds has a relatively low risk. One of the most important studies in this area from Weidig / Mathonet (2004)[14] shows that a portfolio with more than 20 funds has extremely limited risks (i.e. zero risk) with a confidence level of 99% of losing any capital over the entire lifetime of the portfolio. A study from Diller / Herger[15] shows that a well-diversified portfolio of 25 funds spread over 5 years

[13] EVCA Position Paper (2012) "What is a private equity and venture capital fund?"
[14] Weidig/Methonet (2004) "The risk profiles of private equity"
[15] Diller/Herger (2009) Assessing the risk of private equity fund investments

	will end up with a similar result. Meyer / Mathonet (2005)[16] also show that a portfolio with more than 20 funds is considered as being well-diversified. It is therefore not appropriate to apply this look through approach to private equity and venture capital funds. It is also impossible to accommodate larger return potentials and increased diversification effects, which are the main drivers of increased allocations by long term investors, including IORPs, to alternative asset classes if these asset classes, such as private equity, real estate, hedge funds etc are not separated.. Again, this is a repetition of inadequacies inherent in Solvency II. Consequently, we recommend creating a private equity and venture capital sub-module to accurately reflect the standard risk weighting for investing in private equity and venture capital funds and the unique characteristics of private equity and venture capital funds. [12]Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity" [13]EVCA Position Paper (2012) "What is a private equity and venture capital fund?" [14]Weidig/Methonet (2004) The risk profiles of private equity [15]Diller/Herger (2009) Assessing the risk of private equity fund investments [16]Meyer/Mathenot (2005) Beyond the J Curve	
SCR.5.34.		
SCR.5.35.	Any calibration needs to take into account the following : 1. The long term investment & risk horizons of most IORPs : shocks of the mentioned magnitude seem exaggerated even for short term volatile assets.	

[16]Meyer/Mathenot (2005) Beyond the J Curve

	2. A long term horizon needs to accommodate return expectations . Ignoring this point implies a heavy unjustified discriminatory charge on many illiquid high yielding asset categories such as private equity. This type of approach will be detrimental to the funding issues European IORPs and societies at large are confronted with. Such investments are characterised by higher returns and lower risks, especially for longer horizons. IORP's need such long term revenue contributors particularly in times of very low interest rates. At the same time European business needs long term financing to overcome the current crisis. 3. A long term horizon implies that liquidity should play a much less important role in risk measurment. It seems that EIOPA has just modified Solvency II risk charges modestly downwards regardless of the criteria driving the Solvency II calibrations. As can been seen in the EVCA research paper, or in any analysis relying on real private equity data instead of listed private equity data, risk for private equity under Solvency II is heavily exaggerated. Such a choice might have been driven by liquidity considerations. While such a choice is already more than questionable for insurance undertakings, such a heavy impact of illiquidity on risk measures is completely unreasonable for the typical long risk and investment horizon of IORPs. 4. Not only EVCA but also independent academics have shown how heavily flawed the calibration methods are in Solvency II. We urge EIOPA to avoid the use of any inappropriate data and methods for calibration of risk charges for IORPs. The longer horizon might make inaccuracies stemming from the use of inappropriate data and methods even more harmful[17] 5. A proper modelling of diversification effects among alternative investments, such as private equity, hedge funds, real estate and other asset classes is even more important for a long investment and risk horizon. Alternative Investments are often called "alternative" because they are significantly uncorrelated to other assets. Repeating Solvency II calibrations ignores the huge diversification potential in, and between alternatives, and between alternatives and	

[17] Mittnik (2011) Solvency II Calibrations: Where Curiosity Meets Spuriosity

	other asset classes. This lack of recognition of the diversification benefits of alternative assets will be event more detrimental in this context than is the case for insurers under Solvency II. Given this, and the information evidenced in our comments on SCR 5.28, 5.29, 5.33, and 5.38 much lower risk charges for private equity are required. _____ [17]Mittnik(2011) Solvency II Calibrations: Where Curiosity Meets Spuriosity	
SCR.5.36.	See the EVCA comments on SCR 5.35	
SCR.5.37.	See the EVCA comments on SCR 5.35	
SCR.5.38.	The EVCA does recognise the need to measure private equity risk. In order to calculate any theoretical risk calibration and correlations for private equity and venture capital, the full specificities of measuring risk in the asset class should be taken into consideration in order to produce a risk calibration and correlations that are appropriate. In order to achieve this the EVCA strongly recommends that private equity should be classified in an individual, separate sub-module. These specificities together with an appropriate database and calibration methodologies are explained in detail in the EVCA Research Paper "Calibration of Risk and Correlations in Private Equity"[18] presented to EIOPA on May 20th 2012. This EVCA Research Paper demonstrates depending on the calibration method and the data base	

[18] Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"

	used, the shocks for the asset class, and hence the standard risk weighting for private equity, are between 20% and 35%. In addition to an appropriate risk calibration and correlation the specific characteristics of the asset class should also be taken into consideration when classifying private equity and venture capital within the market risk sub-module. These characteristics include: ▪ PE funds typically make long-term, one hundred per cent equity backed, investments; ▪ PE funds do not offer redemption rights for investors; ▪ PE funds do not use leverage at fund level, i.e. they are not exposed at fund level; ▪ PE funds do not engage in credit origination activities. Against the background of these characteristics of private equity and venture capital funds a fund structure has developed that may be defined as follows: "Private equity and venture capital funds are unleveraged funds which predominantly invest in equity instruments and instruments that are economically similar to equity instruments issued by unlisted companies. Such funds are characterised by alignment of interest through sharing of risk between management and investors. They are generally only open to eligible investors, namely professional clients and certain sophisticated HNWIs, and do not provide redemption rights to investors for a period of at least five years after the first closing of the fund, i.e. the date when the first investor is admitted to the fund. Private equity and venture capital funds of funds invest in private equity and venture capital funds as defined above."	

	Consequently, we recommend creating a private equity and venture capital sub-module to accurately reflect the standard risk weighting for investing in private equity and venture capital funds and the unique characteristics of private equity and venture capital funds. _____ [18]Chakravarty/Diller (2012) EVCA Research Paper: "Calibration of Risk and Correlation in Private Equity"	
SCR. 5.39.		
SCR. 5.40.		
SCR.5.41.	In order to assess the appropriate risk and correlation parameters for private equity to be used in a regulatory framework, EVCA ran various analyses and presented the responses to EIOPA on May 20th 2012 in the EVCA Research Paper "Calibration of Risk and Correlations in Private Equity". In this paper EVCA presented two approaches: 1. An approach employing methods used for common statistical procedures and the calibrations of other modules within the QIS 5 Solvency II calibration paper most notably Property. EVCA ran various analyses; starting from a Base Index based on quarterly NAV data up to an Expanded Index which has higher correlation and volatility through the expansion to monthly data. All the empirical data was fitted to use standardized distributions in order to derive the shock and correlation parameters. 2. A cash flow based approach as most investors in private equity focus on the long-term cash flow behaviour of the asset class and are not overly concerned with the quarterly changes of the valuations during the lifetime of the fund. This is because for investors the	

	true economic value of the unquoted investments is only known upon realization of those investments. Using the first approach a correlation figure of 59% and 75% with the MSCI world index was found. Taking this into account and the points outlined inSCR 5.28, 5.29, 5.33, 5.35 and 5.38 the EVCA strongly recommends the creation of a separate and individual sub-group for private equity.	
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SCR.5.46.	The EVCA welcomes the recognition that the long-term nature of a pension funds liabilities should be taken into consideration when calculating the equity risk calibration, however this should be on a sliding scale, which takes into account all characteristics of private equity risk outlined in comment .on SCR 5.28, 5.29, 5.33, 5.35 and 5.38. As such, and irrespective of the duration of the IORP liabilities, investments in private equity funds should be in a separate sub-module.	
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