Comments Template on EIOPA-CP-15-003 Discussion Paper on Infrastructure Investments by Insurers		Deadline 26.April.2015 23:59 CET
Company name:	BlackRock	
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. ○ 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. ○ If your comment refers to sub-bullets/sub-paragraphs, please indicate this in the comment itself. **Please send the completed template to CP-15-003@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-15-003.	
Reference	**Comment**	
Question 1		
Question 2	We believe that long-term debt and equity investments either held directly or on a diversified basis through pooled funds are worthy of a having different risk profile. We recommend focusing on both the construction and operation of long-term infrastructure projects or portfolios in developed countries, and which use established technologies. Sectors that may fulfil this criteria include but are	

not limited to transport, telecommunications, social infrastructure, power plants (conventional and renewable energy), power storage, transmission and distribution and energy infrastructure (e.g. pipelines).

We believe it is important to reflect the underlying rationale insurance companies have to invest in infrastructure as it can provide important low-risk and low-correlation as well as attractive long-term yield. Unlisted infrastructure assets are usually held by insurance companies on a buy-to hold basis and the key economic risk that investors face is not that of liquidating the investment at an undervalue but rather that of counterparty default or prepayment risk.

Making a distinction between Infrastructure Equity and Infrastructure Debt is fundamental both from an investment and investor perspective and determines how the investor holds the investment on its balance sheet. Treating Infrastructure Equity and Infrastructure Debt as two separate asset classes reflects different investment needs as well as differing risk profiles and reactions to market movements and respond to different investment needs.

Depending on the structure of an individual project the overall economics of Infrastructure Equity provide long term investors access to investment opportunities which are well diversified against global equity markets and other investment classes. As such, separate to the consideration of absolute capital requirements at the asset level, we believe that the development of an additional 'Type III' equity based capital requirement might be helpful to reflect the diversification effects inherent in these investments.

Infrastructure debt investments have historically experienced lower default rates and higher recoveries than comparable core fixed income. From a credit perspective these assets can provide a valuable source of both credit diversification and yield pickup. From Moody's historical study over 30 years (referred to below) there is strong evidence that the infrastructure deals are typically not pro-cyclical and have low default correlations to the broad market and other infrastructure investments. We note that there are a number of similarities between infrastructure debt and residential mortgages which are often long term, illiquid and have enhanced recovery rates when compared to corporate debt. In a similar way moving to a risk module based on counterparty default risk rather

	than on ongoing spreads would better reflect the economic experience of insurance investors. The evidence EIOPA requires may be available through a combined analysis looking at: - a bottom-up risk break-down per sector and type of projects and portfolios, -historical performance analysis of infrastructure projects and funds, and -historical performance analysis of unlisted infrastructure companies and funds. For infrastructure debt the Moody's default study published in March 2015 (*Default and Recovery rates for Project Finance Bank Loans and Infrastructure Default and Recovery Rates 1993-2014*) provides the most comprehensive data set we are aware of. The study demonstrates that investment grade quality OECD infrastructure debt is stable with an improving credit profile (i.e. default rates decline over time). This then means that longer maturity debt should not be penalised over shorter maturity debt. A second factor is the benefit of security and probable recovery rates. The fact that most infrastructure debt is secured on assets that "don't go away" is also highly significant to the risk profile of Infrastructure debt investments. Furthermore, as shown in the Moody's study, an external rating in itself does not provide evidence for a different risk profile (as most assets in the study are unrated bank loans).	
Question 3	The majority of insurers look at infrastructure equity and debt as long-term buy-and-hold investment which they do not expect to trade after initial acquisition. For such investors, it is the illiquidity premium that is relevant rather than the liquidity itself. Only for a few investors is demonstrable liquidity a relevant criterion.	
Question 4		
Question 5	While the CRR definition may be a useful comparator we recommend that eligible infrastructure debt should not be limited to project finance but should also include certain corporate finance transactions (e.g. airport investments) with infrastructure investment characteristics.	

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Question 6		
Question 7	Option B or Option A (provided the scope refers to economic and financial features in general terms) or a combination of both would be our preferred options. We suggest that the definition of infrastructure should be wide enough to reflect the specific types of assets involved.	
Question 8	Infrastructure investing includes many types of investment opportunities. We recommend a broad, characteristics-based approach which includes the basic physical systems of a business or nation. These should include transportation, communication, social (hospitals, prisons), sewage, water, electric and energy systems, power and renewable power. These systems tend to be long-term, capital intensive investments that are vital to a country's economic development and prosperity. Due to their importance to society, capital intensity and long-term nature the investments are generally less cyclical than corporate equity and debt. We also draw EIOPA's attention to parallel initiatives to encourage infrastructure investments such as those being lead by the G20/OECD to establish a Global Infrastructure Hub. It is important that definitions are drawn broadly enough so as not to be inconsistent This will avoid the risk of crowding out key projects which might not make the cut of a tightly drawn definition and funnelling investor money into too narrow a range of projects. More generally we recommend avoiding rules that are too prescriptive and so we encourage EIOPA to draw up general regulatory guidelines on infrastructure investment which provide investors with enough flexibility to structure their infrastructure investments as opposed to prescriptive rules.	
Question 9		
Question 10	We do not see the benefit of attempting to define one sector over another as core risks are more likely to be project specific than sector specific. We also refer to the Moody's analysis referred to in question 2 which noted the overall risk profile of infrastructure across a number of sectors.	
Question 11		
Question 12		

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Question 20	The level of construction risk for infrastructure will be dependent on the length and complexity of the construction process. Overall construction risk can often be efficiently managed or mitigated using a few different tools such as: • Specific contractual protections in engineering, procurement and constructions contracts which we would look to include: o fixed price turn-key contracts, o liquidated damages for delay in delivering material elements of the construction project, o sufficient time and capital contingency as verified by an independent technical advisor, or o appropriate assumptions in the ramp-up period. • In the case of Infrastructure Debt rating agencies publish criteria on the minimum standards required to achieve an investment grade construction package. These relate to the subcontracting arrangements, the size, resources, experience of the contractor, the technical challenges of the project, the availability of guarantees and bonding facilities, the amount ofliquidity available, the stage of development of the project etc. While many investment	

	opportunities may not seek a formal credit rating, these critieria reflect the type of analysis and due diligence carried out by investors. • On behalf of investors we would also look to see whether there are additional protections such as prescribed drawdown mechanisms or escrow accounts for undrawn funds. We would also ask whether debt participants are given any say in the management of the project in particular in respect of signing off specific construction phases ahead of drawdown.	
Question 21	As an investor it is important to efficiently manage and mitigate construction risk as appropriate. For example debt investors would typically look at projects which would be likely to fulfil rating agency requirements referred to in question 20, even where the project is not formally rated.	
Question 22	Guarantees from public bodies should be limited to situations where there is inadequate funding available from the private debt and equity markets to avoid the risk of crowding out private monies. In current market conditions this would probably be limited to situations where it is not possible to achieve an investment grade quality debt financing without such public guarantees, rather than further enhancing the quality of viable projects.	
Question 23	The risk of any project and portfolio is a function of both the characteristics of the underlying business (including the revenue risk) and the financing structure itself. Both elements must always be considered as any project can become unstable if it is overleveraged. Conversely, a business which has very low leverage can accommodate more revenue risk and still be highly stable. The robustness of individual projects and portfolios need to be considered on a case by case basis as the amount of leverage and nature of the risks is often project rather than structure or sector specific. The difficulty of the general and prescriptive calculations in the Annex across a broad asset class is that they may not capture the characteristics of a specific project, portfolio or project class and may not focus on the key considerations for a specific project or portfolio under consideration. We would therefore not recommend the use of these criteria. This also comment also applies to Question 24.	

Question 24		
Question 25	We would also recommend considering price / volume hedging (e.g. through the use of financial and bi-lateral contracts).	
Question 26	When assessing the requirements for off-takers it is important to analyse both the probability of default and financial impact of default. The requirement for highly rated off-takers (e.g. low probability of default) should then be higher if the impact of default is significant. Many projects rely on off-take agreements with regulated utilities. These are generally considered reliable subject to the utility maintaining the relevant credit rating although the credit quality of the project itself is unlikely to be higher than that of the off-taker.	
Question 27	Financial ratios analysed depend on the type of project or portfolio. For example analysis for infrastructure debt in projects and portfolios tends to include: • Minimum and Average ADSCR, • Loan Life cover ratios and Project Life cover ratios, and • Operating Cost Cover Ratios. Operating infrastructure businesses (e.g. airports, utility credits, etc.) tend to focus more on criteria such as financial leverage, EBITDA /net debt multiples, FFO/debt multiples. The financial ratios and sensitivities for debt and equity investments in infrastructure projects and portfolios need to be considered on a case by case basis and tested through proper sensitivity analysis.	
Question 28	Minimum levels will be very market and asset class specific and also a function of the characteristics of individual assets / portfolios. It is therefore difficult to set minimum levels for infrastructure assets. However, in terms of generic guidance for debt the credit rating agencies publish broad headline financial metrics and ratios for different asset classes.	
Question 29		
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Question 34	See comments in question 2.	

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Question 35		
Question 36	As mentioned in our response to question 2, the Moody's study has usefully extracted past historical data. In addition and of increasing importance in the future we recommend referring to the track-record from unlisted and listed infrastructure funds in relation to both fund performance and asset by asset performance.	
Question 37		
Question 38	These could include yield cos, listed infrastructure funds, and potentially certain types of utilities, grid and pipeline companies. It should, however, be noted that such listed equities may have higher market correlations and volatilities than unlisted equities in infrastructure projects and portfolios.	
Question 39		
Question 40		
Question 41		
Question 42	As there is only a limited level of data available we do not have evidence to robustly comment on secondary market pricing relative to liquid credit. In any case we do not believe that project bonds would be an appropriate default for broader infrastructure financing.	
Question 43		
Question 44		
Question 45	We do not recommend using a spread-based factor given that the vast majority of infrastructure investments are acquired on 'Hold to Maturity' basis.	
Question 46	Many insurers hold illiquid assets invested in a 'Hold to Maturity' style to back a wide range of liabilities. Such an investment strategy must be supported by a robust liquidity risk management framework. This should explore extreme policyholder behaviour and can determine an appropriate portion of assets which, to a high degree of confidence, will not need to be liquidated in order to meet claims as they fall due. Any hold to maturity style approach is highly dependent upon the nature of insurance liabilities, investment strategy and supporting liquidity facilities available.	

	The matching adjustment mechanism provides an effective basis for considering investments which are held to maturity, but only applies to assets backing a specific type of liability with no policyholder optionality, for example UK annuities.	
Question 47		
Question 48	From an economic perspective, a consideration of counterparty or credit risk is most important for investors who have implemented a buy and hold portfolio which they are confident will not need to be liquidated. Our experience shows this is the case for the majority of insurance company investment into infrastructure. By comparison, an insurer who believes assets may need to be liquidated to meet claims will be highly focused on the price at which assets may be sold, which is effectively tied to spread/rates risk. Any economic consideration that assets should be classified under 'Counterparty Risk' should be driven by a consideration of investment strategy, Asset Liability Matching requirements and liquidity, rather than the specific nature of the underlying asset. Therefore, we believe such a treatment could apply to a range of 'Hold to Maturity' assets. Based upon historical credit performance, we might expect to see a greater deviation between the traditional credit based spread charges and a counterparty type charge for infrastructure debt, as credit performance has been very strong. While such a treatment would not be directly consistent with the treatment of solvency to date, it would take into account a broader economic consideration of the ability to support claims in the context of available ongoing liquidity.	
Question 49	A framework for capital requirements for infrastructure debt may be constructed based upon historic credit performance (default and recovery characteristics), aggregated by project type and rating. We would recommend that EIOPA's work covers not only direct investments into Infrastructure Debt but also the benefits of investment into the asset class through pooled vehicles. This should allow EIOPA to consider recognising the benefits of holding pooled portfolios of infrastructure assets managed by teams with dedicated infrastructure expertise. We particularly encourage EIOPA to consider the benefits of investing in infrastructure through ELTIFs (as a closed-ended fund for buy-to-	

	hold investors with limited leverage and a diversified pool of assets) and other similar AIFs.	
Question 50		
Question 51	For infrastructure debt it is probably appropriate to use internal bank rating models and also those developed by institutional investors with specialist teams and specific internal credit scoring models provided they follow established rating agency methodologies. Care should be taken to establish robust internal credit processes which are both independent of investment committees, and have methodologies which, where appropriate, are externally audited.	
Question 52		
Question 53	Yes, this is normally the case.	
Question 54	There is no set industry standard but broadly speaking there are a number of modelling principles that most models would follow. Models would normally be audited.	
Question 55	In the case of infrastructure funds the key information will be set out in the statement of investment objective, restrictions and guidelines. Infrastructure funds in Europe are subject to detailed disclosure requirements under the Alternative Investment Fund Managers Directive (AIFMD). A number of project bonds have already been issued with detailed offering documents, particularly in the sterling and US private placement markets. These should be used as a reference point.	
Question 56	A level of standardisation would be helpful. It is important to ensure that the sales and marketing process doesn't oversimplify the transaction and that key risk specific to the transaction are highlighted rather than being buried in a long section of generic risks. It's important to ensure that infra practitioners are involved in drafting the key risk section.	
Question 57	In the case of investment funds any offering documents for funds sold to European investors would need to be prepared in accordance with the AIFM Directive and Regulation. In addition, the requirements of the European home state national competent authority (NCA) would need to be met. Detailed application forms are usually submitted with the offering documents to confirm to the NCA that all of its specific requirements and standards are adhered to.	

	AIFMD imposes ongoing detailed and prescriptive reporting requirements on positions held within the fund and key counterparty exposures. This information is reported not only to the NCA but forwarded by the NCA to ESMA and ESRB.	
Question 58		
Question 59		
Question 60		