

| Comments Template on EIOPA-CP-15-003 Discussion Paper on Infrastructure Investments by Insurers | | Deadline 26.April.2015 23:59 CET |
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| Company name: | Gesamtverband der Deutschen Versicherungswirtschaft e.V., GDV (German Insurance Association) | |
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| <p>Please follow the instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ <u>Do not change the numbering</u> in column "Reference". ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below. <ul style="list-style-type: none"> ○ 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. <p>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).</p> <p>The paragraph numbers below correspond to Consultation Paper No. EIOPA-CP-15-003.</p> | | |
| Reference | Comment | |
| Question 1 | <p>Introductory Remarks:</p> <p>Investments in infrastructure and renewable energies constitute a new asset class generating predictable and stable revenues. Due to their predictable long-term liabilities, insurers are able to invest in these illiquid assets in order to diversify and to match their corresponding obligations.</p> | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

Unlisted investments in infrastructure and renewable energies are not subject to short-term trading and have to be valued based on their future net returns. The fluctuations of the cash-flows – which are often regulated or even guaranteed – are quite small, so that the assets' economic value is comparatively stable. Under Solvency II, however, long-term investments in infrastructure and renewable energies are still assigned to the same high risk factor as hedge funds or commodities of up to 59 % for equity risk type 2.

In fact, a distinction between listed and unlisted infrastructures is crucial. While listed infrastructure's characteristics are similar to global equity, the returns of unlisted infrastructure exhibit much lower volatility and are nearly uncorrelated with both listed infrastructure and global equity. Therefore, the current treatment is not appropriate. Unlisted infrastructure has rather bond-like characteristics. It generates a cash-flow that is mainly subject to technical-physical risks which are independent from the common market risks. Therefore, these assets should be subject to a new sub-module "infrastructure risk". Due to the wide range of possible investments, its risk factor should be set at a prudent level of 20 %. Furthermore, a list of criteria should exclude projects with higher risks. On top of that the net present value of the cash-flow is subject to interest rate risk which should be considered in the regular sub-module for interest rate risk. Thus, there should be no correlation of the infrastructure risk with equity risk, interest rate risk or any other market risk.

Those assets, for which the data basis is not sufficient to calculate the interest rate risk, should be subject to the property risk sub-module. The infrastructure and interest rate risk sub-modules should not apply in this case. This fallback solution would still be more appropriate than the current application of the equity risk sub-module which should only apply to investments that are listed or do not comply with the criteria.

This proposal, calling for the recognition of the particular features of infrastructure and renewable energies in the standard formula, serves the public interest to encourage more long-term investments of this kind in an appropriate and easily realizable way.

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

Specific answer Q1:

Within the Solvency II framework inadequate capital requirements are seen as the main disincentive to invest in infrastructure. Within Solvency II we don't see other material elements preventing insurers to invest.

Another regulatory obstacle apart from the capital requirements under Solvency II is the existing regulation on unbundling. Participation of financial investors in investments in renewable energies and infrastructure is impeded by existing supervisory provisions on unbundling stipulated by the European Union. Strict separation of energy production and energy transportation results in an "either or" conflict and thus reduces the available financing volume of private investors. Amending the respective regulatory provisions accordingly could enable participation of financial investors along the entire value chain of the energy industry without challenging the objectives of the provisions on unbundling. Directive 2009/72/EC and Directive 2009/73/EC should therefore be revised in the medium term. Since a revision of the mentioned Directives will probably take some time, the Impact Test required by the European Commission should be simplified in the meantime and the criteria of the test should be made transparent. Simplification of the test is necessary since it is very time consuming, entails significant costs and brings about a high level of uncertainty for investors. Moreover, the criteria for a positive decision required by the European Commission are neither transparent nor public. The criteria regarding the Impact Test should therefore be published and clearly defined. With respect to financial investors for whom an investment in the energy industry is not part of their strategic core business, it should generally be assumed that they comply with the provisions on unbundling. Moreover, for reasons of legal certainty, projects and holdings once approved should not be affected by decisions made by the Commission at a later point of time.

Another obstacle for insurers to investing in infrastructure is that financial statements of financial institutions, in which insurance undertakings own directly or indirectly more than 20 % of the capital or voting rights, have to be available and closed until February of each year at the latest. Only then it

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|------------|---|--|
| | <p>is feasible to calculate own funds and capital requirements for those financial institutions and to include those amounts within the calculation of group solvency. For the calculation and the reporting of group solvency within the Solvency II reporting deadlines those information used for the calculation of solvency at solo level should be considered sufficient at group level. Information on group solvency should be disclosed in two reports: one report to the public (SFCR) and one report to the group supervisor (RSR) (see Art. 359 and 372 of Regulation 2015/35/EU, Delegated Acts). The deadline for disclosure of the two reports is 14 weeks after the financial year end which are extended by 6 weeks (see Art. 362 and Art. 300 of the Delegated Acts). For the years after the entry into force of Solvency II in January 2016, there is a transitional period with extended deadlines which are reduced by two weeks per year to arrive at 20 weeks at the end of the transitional period in 2020. In addition to Solvency II reporting, groups with a balance sheet total above EUR 12 bn. are required to meet the additional EIOPA reporting requirements for financial stability purposes. These additional reporting requirements are based on the Solvency II data requirements. However, the deadlines for submission are further reduced to 9 weeks after the financial year end at the start of the transitional period in 2016, and to 6 weeks at the end of the transitional period in 2020. If the information necessary for calculating the group solvency concerning a related undertaking (here the financial institution) is not available, the book value of that undertaking must be deducted from the own funds of the group (see Art. 229 of Directive 2009/139/EC, Solvency II Directive). This in general will lead to a distorted presentation of group solvency only because of the fact that those data cannot be delivered in time. In practice, insurance undertakings often do not invest in infrastructure directly but through fund vehicles. The purpose of those vehicles is to acquire and hold participations. As a consequence, those undertakings fulfil the definition of financial institutions (see Art. 4 (5) of Directive 2006/48/EC). In case insurance undertakings hold more than 20 % of the capital or the voting rights, those vehicles have to provide for information that enables the insurance undertaking to calculate own funds and a capital requirement according to sectoral requirements, i.e. Basel requirements. However, those vehicles in general cannot give a binding commitment to deliver the required data in time so that it can be considered within the calculation of group solvency.</p> | |
| Question 2 | <p>Generally, the standard formula for both infrastructure equity and debt instruments across various sectors is not seen as appropriate under Solvency II. The standard formula treats infrastructure investments as any other exposures to corporate bonds or general equity and therefore takes not into account for example the higher recovery rates that infrastructure investments have demonstrated in the past (see Moody's: Default and Recovery Rates for Project Finance Bank Loans,</p> | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|------------|--|--|
| | <p>1983-2013, published in February 2015). Furthermore, the standard formula does not replicate one of the strongest benefits of infrastructure as infrastructure assets become safer the longer they run. On average after 7-10 years in operation annual probabilities of default tend to be near 0%.</p> <p>From a risk management perspective infrastructure investments are seen as favorable for insurers, since they help to match long-term liabilities with equally long-term assets. Cash flows and the value generated by them are predictable and stable. This is because cash flows are mostly regulated or long-term contracted with counterparties. Moreover, they represent a good source of diversification and are not correlated with other market risks. Therefore a risk-adequate treatment under Solvency II should be achieved for all infrastructure investment vehicles.</p> | |
| Question 3 | <p>Illiquidity is a fundamental characteristic of infrastructure projects and the illiquidity premium integral part of the expected return. Liquidity management of life insurance companies is based on the whole asset portfolio. Thus the introduction of a liquid infrastructure asset class with higher transparency is beneficial, but illiquidity is not a major obstacle. Starting from a relatively low level, insurers have increased their infrastructure investments significantly both in relative and absolute terms over the past years. However, their current allocation to infrastructure is still around 1 % only. While we believe that this portion is likely to grow we do not expect it to grow beyond 5 % for the industry soon. This is due to the overall still low level of available infrastructure assets. Therefore low levels of liquidity for infrastructure investments are not seen as an issue within in the portfolio context.</p> <p>Moreover, when considering liquidity risks the business model of insurers should be adequately reflected. Due to their predictable long-term liabilities, insurance companies are able to invest in a relatively large portion of illiquid assets. For this reason insurers are exposed to liquidity risks to a much lesser extent than for example banks. Solvency II encourages insurers to match assets and liabilities. Matching assets and liabilities allows insurers to avoid exposure to forced sales of assets and also allows insurers to hold the assets that they acquire throughout the lifetime of these assets. The existence of illiquidity premiums further improves insurers' portfolio performance.</p> <p>The risk management requirements of Solvency II already require insurers to reflect on liquidity risks</p> | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|------------|--|--|
| | <p>in their written policy on risk management and in their ORSA reports. Any further requirements in order to address liquidity risk are not necessary. For all insurers' investments, Solvency II requirements on the prudent person principle apply, which ensures the right framework conditions for investment decision-making to serve the interests of policyholders. According to the prudent person principle the illiquidity requirements have to fulfill only on the portfolio level.</p> <p>Consequently the existence of illiquid markets for infrastructure investments can rather represent an advantage than a disadvantage for insurers who have the ability to invest long-term.</p> | |
| Question 4 | <p>We believe that a distinction between external and internal ratings would not make much sense. Limiting preferential treatment to investments with an ECAI rating would even contradict the intention of the rating regulation CRA III (Regulation 462/2013) since the CRA III intends to reduce companies' dependence on external credit ratings. If a public or non-public credit rating by an ECAI credit rating agency exists than the external rating should be used to determine the capital requirement of the infrastructure investment complemented by internal assessment if appropriate.</p> <p>In case an external rating by a recognized agency does not exist, which will quite often be the case, then only the investor's own credit assessment should be used to determine the regulatory treatment.</p> | |
| Question 5 | Stipulating definitions from banking regulation for insurance is generally not seen as appropriate. Please refer to our answer to Q7. | |
| Question 6 | We are not aware of other legal definition. | |
| Question 7 | There is an enormous variety of potential investment objects in the field of infrastructure and renewable energies, involving highly divergent real, economic and legal environments. For this reason, defining certain types of infrastructure investments with a lower risk profile does not make much sense. The most reasonable approach for identifying preferential regulatory treatment is to define characteristics of relatively low risk infrastructure investments rather than certain types of investments. This way only comparatively low-risk cases are included – for which a common calibration can be found – excluding cases associated with higher or unpredictable risks. This approach is based on a list of requirements, which do not relate to specific categories of investment | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

objects, but rather to general criteria ensuring the low-risk, bond-like character of an investment. As a consequence the definition for infrastructure has to be very broad in line with point (a) of the Discussion Paper (see below) with a recital illustrating types of infrastructure investments (see below) and additional suitable criteria (see answer to Q11) to eliminate infrastructure investments where lower risk charges are not appropriate.

Possible Definition for SII (to be inserted in Article 1 of the Regulation EU 2015/35):

'Infrastructure' means assets including networks, facilities, utilities and installations that support the current or future functioning of a community or society, whether at local, regional, national, EU/EEA or international level, and exhibit specific economic and financial features relating to credit risk, demand and competition as result of the function provided and restrictions on ownership and/or use of the assets.

Recital:

The definition of infrastructure should capture the broad range of assets such as but not limited to public institutional buildings (including corrective institutions and prisons, defence accommodation and training facilities, fire stations, schools, student accommodation, universities and other public buildings), social or retirement housing, car parking structures, combined heat and power plants and district heating systems, desalination plants, energy generation and power transmission, distribution and metering (including gas, hydro, nuclear, wind & solar power installations, waste to energy conversion plants, interconnectors, pipelines), environmental facilities (parks, flood or tidal protection including dredging), health care (including long-term care centres, mental health facilities, primary care and health care centres – including hospitals), information technology and communication systems (including broadband and cable, broadcast infrastructure including broadcast towers, telecom towers), large-scale civil engineering projects, renewable energies, storage facilities, street lighting, transportation and associated technologies (including airports, bridges, ports, roads, rail including high-speed lines, rolling stock and locomotives), waste, research and development activities, water including waste water. Often, a significant part of the revenues from such assets are subject to regulation or contractual clauses with a State authority. These characteristics result in common financial features that are predictable, steady and long-term cash flows.

Question 8

Please refer to our answer to Q7.

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|-------------|---|--|
| Question 9 | We are not aware of any. | |
| Question 10 | We do not support an approach that completely excludes infrastructure sectors from the scope of the calibrations' review. As stated above, features should be based on a list of requirements, which do not relate to specific categories of investment objects or sectors, but rather to general criteria ensuring the low-risk, bond-like character of an investment. For example, technological risks can be effectively mitigated by guarantees, contractual agreements or scenario analysis. As a consequence the definition for infrastructure investments should be broad. | |
| Question 11 | <p>'Infrastructure exposure' that qualifies for a more favorable treatment than in the current version of the standard formula means exposures that fulfill all or most of the following characteristics:</p> <ul style="list-style-type: none"> (a) the exposure is to an entity that was created specifically to finance or operate infrastructure assets; (b) the exposure does not have the form of listed equity; (c) the primary source of payments to the investors is the income generated from the assets being financed or from contractual arrangements such as revenues from private or public sector institutions; (d) Long-term stable and predictable cash flows (see reference 1); (e) Low correlation with other assets (see reference 2); (f) Monopolistic market position in an accommodating regulatory framework, inelastic demand or limited competition; (g) the initial maturity at issuance is [5] years or longer; | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

(h) If the exposure is to green field investment in the construction phase, the construction risk is appropriately mitigated and passed through under a comprehensive engineering, procurement and construction (EPC) contract.

(i) The assets are located in member state of the Union or the OECD or country specific risk is effectively mitigated by guarantees or insurance.

Given the enormous variety of infrastructure investments it would be very difficult to establish any form of comprehensive certification for the above mentioned criteria. Insurers should be themselves responsible to conduct the necessary assessments and to monitor and document their processes and findings. It should be up to the national regulators to discuss and challenge these internal assessments with the undertakings.

Reference 1: Given the enormous variety of infrastructure investments it would be very difficult to establish any form of comprehensive certification for the above mentioned criteria. Insurers should be themselves responsible to conduct the necessary assessments and to monitor and document their processes and findings. It should be up to the national regulators to discuss and challenge these internal assessments with the undertakings.

Reference 2: When determining appropriate correlations between infrastructure risk and other market risks, it has to be taken into account that the standard formula for SCR calculation only allows for intervals of 0.25 and that the correlations should be consistent among different combinations of market risks. If the newly defined infrastructure risk included interest rate risks of varying levels, particular difficulties would arise, since it would not be possible to determine generally applicable correlations with interest rate up and interest rate down risk. This problem is solved by excluding any interest rate risks from the infrastructure risk module, which essentially refers to technical-physical risks (independent of typical market risks) only. Accordingly, zero correlations only are proposed for

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|-------------|---|--|
| | <i>interest rate, equities, property, spread, concentration and currency.</i> | |
| Question 12 | <p>Please refer to our answer to Q11. The returns of unlisted infrastructure exhibit much lower volatility and are nearly uncorrelated with both listed and infrastructure and global equity (see reference 1).</p> <p>Overall, infrastructure investments are characterised by higher recovery rates than for example corporate bonds (see reference 2). Although debt instruments are analysed, the basic findings are applicable to equity investments, too. The study, which covers data from 4.067 unrated projects worldwide, comes to the conclusion that default rates of infrastructure investments are similar to corporate debt with a BBB/Baa rating. However, for infrastructure and energy very high recovery rates of more than 80 % can be observed over the duration of the investments. For this reason, it can be concluded that the actual credit default rates of infrastructure investments can be compared to A-rated bonds. Moreover, the Moody's study even misses some advantages of infrastructure investments since structural elements in the contracts are generally not taken into account by rating agencies. Given that under the current Solvency II standard formula it is assumed that infrastructure investments behave like any other exposures to for example corporate bonds or equity, a more tailored approach to measuring underlying risks and implicit capital requirements is justified.</p> <p><i>Reference 1: See J.P. Morgan Asset Management, Global Real Assets (2013): A case for Core Infrastructure.</i></p> <p><i>Reference 2: See Moody's Default and Recovery Rates for Project Finance Bank Loans, 1983 - 2011.</i></p> | |
| Question 13 | <p>We object to the European insurance sector being regulated by standards that are developed by EBA. Apart from the more general concerns we also believe that the banking approach does not fit the business model and real risk profiles of insurance companies. Moreover, the approach is viewed as being too complex to be applied in the standard approach under Solvency II. Finally, the EBA Regulatory Technical Standards are not yet available hence it is not at all possible to comment on the content itself.</p> | |
| Question 14 | <p>The Solvency II pillar 2 requirements ensure that elements in the Basel II list such as Financial strength / Political and legal environment / Transaction characteristics / Security package / Strength of sponsor are covered under the prudent person principle in Solvency II.</p> | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|-------------|--|--|
| Question 15 | We do not believe that the criteria should be adopted under Solvency II. | |
| Question 16 | We are not aware of any other such definitions in legal texts. | |
| Question 17 | We believe that the criteria described under Q11 would be effective to eliminate infrastructure investments for which a different treatment in the standard formula would not be justified. | |
| Question 18 | Please refer to our answer to Q11. | |
| Question 19 | Please refer to our answer to Q11. | |
| Question 20 | <p>The decision for or against an investment and the acceptable level of risk is always down to the specific situation at the respective company. Insurers will try to either avoid or minimize risks that are difficult to control or calculate by various means. Risks that insurers will often chose to avoid include new technical risks with very limited trackrecord/experience and high loss potential such as offshore wind projects or significant political risks and the project risk during the planning phase up to the public approval. Risks that insurers are willing to accept often include interest rate risk, cost risk, contractual/legal risk and to a lesser extend technical risk (where there is an adequate track record of similar projects that makes the technical risk calculable) and political risks (preferably in jurisdictions with a track record for legal certainty and protection of investor rights). Many insurers try to avoid technical and political risks altogether.</p> <p>An important overarching risk mitigant for every investment is a supportive regulatory environment. When deciding about what risks to accept a key aspect for risk mitigation is the selection of experienced partners with excellent track record and/or rating. The assessment of partners can be helped with third party letters of credit/surety bonds. Other risk mitigation techniques include for example state guarantees, co-financing, hedging, insurance coverage and contractual agreements such as for example fixed price contracts. Contractual agreements should include enforcements rights to be effective. One example for a contractual agreement that mitigates risk is an EPC (Engineering, Procurement and Construction) contract. EPC is a common form of project handling in international construction, where a general contractor commits to supply a turnkey plant or building to the client, usually at a fixed price and by a certain deadline (contract penalty included). Another type of risk mitigant can be offtake contractual agreements (Power purchase agreement) where price and</p> | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|-------------|---|--|
| | <p>quantity of electricity purchased are predetermined.</p> <p>Another approach to risk mitigation is portfolio diversification – at overall portfolio level, but also within a segment – for which an appropriate deal flow and deal size are needed.</p> | |
| Question 21 | Please refer to answer to question 20. | |
| Question 22 | In order to prevent crowding-out of institutional investors, credit enhancements and/or guarantees should only be applied where construction or other risks are considered so material that there is no private financing available. Credit enhancements and/or guarantees are reflected in the features and parameters of the product, such as level of risk premiums and, if available, the assessment of credit quality and/or recovery rate. There is therefore no need for further definitions. | |
| Question 23 | 2/3 of low volatile cash flows could be considered as a suitable threshold. The outlined approach is however regarded as too restrictive. Lower risk should not be associated only with government offtakers. Low cash flow volatility can also be achieved via contractually fixed cash flows with strong private counterparties. A regulatory revenue scheme should not be a prerequisite. A restriction to PPP is also not seen as feasible since this would exclude a large portion of suitable and secure projects and narrow the scope significantly. Overall the number of PPPs is relatively small in the European Union. | |
| Question 24 | For an assessment of revenue risk a comparison between revenues under severe stresses and expected revenues can be used. Given this ratio is above a certain threshold the revenue risk might be considered to be low. | |
| Question 25 | Please refer to our answer to Q23. | |
| Question 26 | Examples include payments from regulated corporates (based on individual customers), fees from airports and ports or revenues generated by toll roads. | |
| Question 27 | In general, relevant financial ratios are project specific. Therefore there should be no prescriptive ratios but only principles of inclusion as criteria for the purpose of Solvency II if at all. Insurers should be themselves responsible to conduct the necessary assessments and to monitor and document their processes and findings. It should be up to the national regulators to discuss and challenge these internal assessments with the undertakings. | |
| Question 28 | Please refer to our answer to Q27. | |
| Question 29 | Please refer to our answer to Q27. A subordinate debt instrument can still have a very strong credit | |

| Comments Template on EIOPA-CP-15-003 Discussion Paper on Infrastructure Investments by Insurers | | Deadline 26.April.2015 23:59 CET |
|--|--|---|
| | quality and an attractive risk return profile depending for example on the overall financial strength of the issuer, the respective terms and conditions of the instrument or the level of overall asset encumbrance. | |
| Question 30 | It is not necessary to limit the refinancing risk. It is unrealistic to avoid the refinancing risk completely. Availability of long term funding with the same maturity as the infrastructure project is very limited and moreover often makes not much sense because of the relative high charges. The refinancing risk should be considered in the prudent person principle. | |
| Question 31 | A debt capital investment in infrastructure should ideally have as little pre-payment risk as possible. Prepayment risks are generally considered important but they are currently adequately limited for example with breakage costs at the issuer level or terminations costs. Further suitable measures to limit the prepayment risk are non-call periods or make-whole provisions. Moreover, these risks are already adequately covered under existing pillar 2 regulation (liquidity management). | |
| Question 32 | | |
| Question 33 | Against the background of a significant variety of potential infrastructure investment objects it is only natural that certain important criteria are not easily verifiable or quantifiable. However, the introduction of Solvency II increases the responsibility for insurers themselves to prudently assess the risks of their investments rather than to rely on fixed quotas or risk metrics. Therefore insurers should be free to ensure that set criteria are followed in an adequate way. Internal ratings or sound internal validation activities should also be allowed in this context. The assessment of an insurer, that a certain set of criteria (e.g. low default risk) is met, has to be documented and monitored in a reasonable way. National supervisors can ask companies to discuss the assessment and to provide documentation that sheds light on the decision process of the insurer. | |
| Question 34 | For infrastructure equity: Within the market risk module, a special sub risk-module for unlisted equity investments in infrastructure and renewable energies is introduced, reflecting the technical-physical risks the expected returns are exposed to. This should not be part of the equity risk module. Given the wide range of potential investment objects, in this new module a conservative risk factor of 20% is applied to the economic value of the investment. Investments associated with higher or unpredictable risk | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|-------------|---|--|
| | <p>are excluded through a list of criteria (please refer to Q11).</p> <p>A zero correlation has to be applied between the sub risk-module for infrastructure risk – which is independent of the capital market – on one side and the sub risk-modules for equity risk, interest rate risk and other market risks on the other side. Investments in infrastructure or renewable energies that do not meet the list of criteria or that are listed remain exposed to equity risk. Where equity risk is maintained, infrastructure risk and interest rate risk are not applied (see reference 1).</p> <p>For infrastructure debt:</p> <p>The preferred solution is a treatment under the counterparty default risk module, as type 2. As a fall back solution a reduced risk factor and a lower cap on the duration factor for spread risk could be feasible which would reflect the better recovery rates and the lower probability of defaults in the long run (annual PD's near 0% once 7-10 years post construction) exhibited by infrastructure compared to other corporate bonds.</p> <p>Reference 1: For more information please refer to GDV (2013): Proposal for an appropriate solvency capital requirement for long-term investments in infrastructure or renewable energies.</p> | |
| Question 35 | <p>Internal models best capture the individual risks of an undertaking. However, the development and the approval process of such models is very onerous. Therefore the standard formula is likely to be used by the vast majority of insurers. It has to capture appropriately their material risks. This includes the specific risks associated with infrastructure investments. Assessing these risks with a (partial) internal model can only be an alternative for undertakings using a (partial) internal model anyway. In order to ensure that investment in infrastructure is a viable option for the widest range of insurance companies across Europe, it is important that the standard formula is adapted to appropriately reflect the actual risks that insurers are exposed to when investing in such assets.</p> <p>The discussion on infrastructure should not have an impact on the requirements for the use of an internal model. Any 'special' requirements for internal models on infrastructure could discourage</p> | |

| Comments Template on EIOPA-CP-15-003 Discussion Paper on Infrastructure Investments by Insurers | | Deadline 26.April.2015 23:59 CET |
|--|--|---|
| | investments from insurers with well-established and tested internal models that would need to change to adapt to potentially new, prescriptive requirements. We therefore believe that the focus of EIOPA's work should be on recalibrating the standard formula to better reflect the risk of infrastructure assets. A solution based on internal models would neither be enough nor appropriate. | |
| Question 36 | Individual investors have access to extensive data following an actual investment or due diligence process. However this data is not public. Generally, banks and credit rating agencies collect cash flow data on infrastructure projects. Credit rating agencies publish regularly studies on defaults and recovery rates that could also be used. | |
| Question 37 | | |
| Question 38 | <p>For listed infrastructure equities, we believe there is a high correlation with type 1 equities and it is relatively difficult to differentiate the risk profiles so we would advise that they remain in the type 1 category. A distinction between listed and unlisted equity infrastructure investment is crucial. While listed equity infrastructure's characteristics are similar to global equity, the returns of unlisted equity infrastructure exhibit much lower volatility and are uncorrelated with both listed equity infrastructure and global equity. Unlisted equity investments in infrastructure are not subject to short-term trading and have to be valued based on their future net returns.</p> <p>Under Solvency II equity investments in infrastructure are still assigned to the same high-risk factor as hedge funds or commodities of up to 59 % for equity risk type 2. For an alternative and more risk adequate approach please refer to Q34.</p> | |
| Question 39 | | |
| Question 40 | We believe that infrastructure listed equities have a similar risk profile to type 1 equities and a high correlation with them. | |
| Question 41 | Please refer to our response to Q34 and Q38. The returns of unlisted infrastructure exhibit much lower volatility and are nearly uncorrelated with both listed infrastructure and global equity (see reference 1). Therefore, we believe they should be treated in a separate sub risk-module, with a zero correlation towards the other types of equities. We think a dedicated infrastructure module is more appropriate than a "Type 3" equity module. | |

**Comments Template on EIOPA-CP-15-003
Discussion Paper on
Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

| | | |
|-------------|--|--|
| | <i>Reference 1: See J.P. Morgan Asset Management, Global Real Assets (2013): A case for Core Infrastructure.</i> | |
| Question 42 | Project bond spreads can be deducted from information providers such as Bloomberg. However project bonds currently only account for a small number of all infrastructure financing and tend to be focused on lower risk projects (government related large project) in OECD countries. Therefore project bonds seem to be inappropriate as a proxy for all project financing. Moreover, infrastructure bonds are often held to maturity and therefore trading volumes are limited. | |
| Question 43 | JP Morgan 2013 study shows that credit spreads for infrastructure project finance debt are sustainable around 250 to 300bps and have exhibited much lower volatility than corporate credit, especially during the 2008-2009 crisis where they were less volatile than 'A' rated corporate bonds. | |
| Question 44 | Loss given defaults are significantly higher for corporate debt. The counterparty default risk module should therefore be considered instead of looking to the spread part since it does not move the same way as for "normal" corporate bonds. This approach would allow the calibration of the capital requirement for infrastructure debt to reflect higher recovery rates (as compared to corporate bonds) and the existence of risk mitigation tools (e. g. collateral) that reduce the loss given default. | |
| Question 45 | There is evidence that infrastructure investments react less (or even not at all) to general financial market movements due to their long-term nature and underlying exposures and market environments often close to a natural monopoly with inelastic demand. There is also evidence that the risks of default and/or recovery rates of infrastructure investments exhibit better performances than those of corporates. The calibration of capital charges for infrastructure investments have to allow for the recognition of the specificities of infrastructure and implicit lower investment risk, as well as for the recognition of the low correlation between infrastructure risk and other asset risks. Spread risk should not be considered, since long-term investments such as infrastructure investments are often held to maturity and are hence not exposed to spread risk. | |
| Question 46 | Because of their long-term liabilities insurance companies are inherently interested in infrastructure investments with long maturities that they can hold to maturity. Please refer to our answer to Q3. | |
| Question 47 | Infrastructure facilities are usually not – or only to a small degree – subject to market competition, since their services are difficult to replace and the cash flows are predictable and stable. | |
| Question 48 | Studies from industry experts such as Moody's show that default multiples for infrastructure investments are lower than for corporates and recoveries are higher because of the intrinsic value | |

**Comments Template on EIOPA-CP-15-003
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Infrastructure Investments by Insurers**

**Deadline
26.April.2015
23:59 CET**

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| | and often monopolistic characteristics of infrastructure compared to SME or corporate loans. | |
| Question 49 | <p>Compared to corporate bonds, infrastructure debt shows much higher recovery rates: For example Moody's 2015 report on Default and Recovery Rates for Project Finance Bank Loans, based on data from 1983 to 2013, showed ultimate recovery rates for infrastructure of around 77 % while corporate bonds showed ultimate recoveries from 28 % (subordinated bonds) to 63.5 % for senior secured bonds (see reference 1). An approach via the counterparty default risk module would allow the calibration of the capital requirement for infrastructure debt to reflect higher recovery rates (as compared to corporate bonds) and the existence of risk mitigation tools (eg collateral) that reduce the loss given default. Furthermore and shown in the Moodys Study the annual default rates for infrastructure projects tend to go to zero once the infrastructure is operating for a couple of years. This shows a huge difference to the plain corporate world as well. For this reason, we believe the inclusion of infrastructure project debt in the current type 2 would be satisfactory.</p> <p>In terms of correlation, we believe there should be no correlation between infrastructure and other types of bonds or debt since infrastructure does not "behave" in the same way.</p> <p><i>Reference 1: See Moody's Annual Default Study: Corporate Default and Recovery Rates, 1920-2013, published in February 2014</i></p> | |
| Question 50 | <p>We believe it would make sense to treat infrastructure as type 2 in the counterparty default risk module since infrastructure presents an economic substance which is quite similar to mortgages, e. g. with the reliance on collateral, or the cash flows arising from the project. This treatment could still be seen as slightly conservative since for infrastructure there is not as much dependence to the financial strength of the borrower.</p> <p>We also believe that from a practical point of view the treatment as type 2 would be easier since it only requires the calculation of the loss given default (not the probability of default) which is possible for both rated and unrated projects.</p> | |
| Question 51 | Non-existence of an ECAI is not indicative of non-quality. Unrated debt should be included in the | |

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| | <p>analysis next to rated debt. Excluding unrated debt would be unjustified from a risk perspective and reduce the number of investments significantly that could qualify for a reduced capital requirement.</p> <p>Moreover, limiting preferential treatment to investments with external ratings would contradict the intention of the rating regulation CRA III (Regulation 462/2013) since CRA III intends to reduce companies' dependence on external credit ratings. If a public or non-public credit rating by a recognized credit rating agency exists than the external rating should be used together with an internal assessment where appropriate. In case an external rating by a recognized agency does not exist (which will quite often be the case) then only the investor's own credit assessment should be used.</p> | |
| Question 52 | We believe that there is a strong case for a tailored regulatory treatment of debt and equity infrastructure investments under Solvency II. EIOPA should seek for an approach that is easy to implement and operate. In particular, we believe that due to already existing requirements under pillar 2 prescriptive areas should be limited to absolutely necessary areas. | |
| Question 53 | The project sponsors usually provide financial models which can be used to evaluate the resilience of the project to (upside and) severe downside stress scenarios. Models highlight risks such as refinancing gaps, changes in regulation, market conditions or project specific risks. For example, the financial model for a wind power station has to evaluate the financial implications in case of 10 % less wind than predicted in the wind evaluation. | |
| Question 54 | We believe that modelling is always company/project specific. Hence, EIOPA should not aim to develop a too prescriptive framework. This would also contradict the principles based approach of Solvency II. | |
| Question 55 | Reporting obligations are already contained in the offering documents for public bonds and in the finance documentation for private financing. We don't see that such information should be standardised against the background of differing project requirements. Availability of prospectus information should be encouraged through different policy measures and not through prudential regulation. | |
| Question 56 | The existence of standardised information is not an indication of "quality" in itself, but rather a helpful means to conduct investment analysis and necessary due diligence. Prudential treatment of infrastructure investments should not become contingent on the availability of for example certain reporting templates. A specific list of information could create additional costs to sponsors without | |

| Comments Template on EIOPA-CP-15-003 Discussion Paper on Infrastructure Investments by Insurers | | Deadline 26.April.2015 23:59 CET |
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| | always adding value. | |
| Question 57 | | |
| Question 58 | Standardised provision of information is a product feature and should not be part of prudential regulation in the context of a more risk adequate treatment of infrastructure investments under Solvency II. Standardisation of information could increase costs for borrowers without adding useful knowledge for investors. | |
| Question 59 | As a general principle, insurers will try to either avoid or minimize risks that are difficult to control or calculate. Projects that have non-measurable risks or can lead to high losses are not attractive for insurers. From this perspective, standardisation can help insurers better perform the risk analysis of projects. Insurers need detailed information on every project in order to perform risk analysis. More standardisation and transparency could make it easier for insurers to perform the necessary pre-investment analysis of opportunities. However, information requirements differ depending on project specifics, jurisdiction, legal regimes and contracting parties. Hence, the development of standardisation should be left to the market and should have no prudential implications. | |
| Question 60 | As noted above, standardisation can play a role in increasing the attractiveness of a given project and, implicitly, its tradability. Investors have specific needs and make decisions based on their individual needs and available assets that can meet these needs. Therefore, the development of standardisation should be left to the market and should have no prudential implications. | |