

Comments Template on EIOPA-CP-15-003 Discussion Paper on Infrastructure Investments by Insurers		Deadline 26.April.2015 23:59 CET
Company name:	Insurance Europe	
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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>Key positions:</p> <ul style="list-style-type: none"> ■ Insurance Europe supports a high-level, all-encompassing definition of infrastructure. A tailored treatment for long-term infrastructure projects is needed to better reflect the risk profile of infrastructure assets, as well as the real risks that insurers are exposed to when investing in them. ■ Changes to the standard formula are key. A solution based on internal models is not appropriate and would introduce new constraints at a time when companies are in the process of submitting internal model applications. 	

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- Insurance Europe calls for changes in the Solvency II standard formula as follows:
 - Unlisted infrastructure equities should be captured under a new sub-module in the market risk, with a 22% charge and a correlation of zero with other sub-modules.
 - For infrastructure debt, Insurance Europe recommends a treatment under the counterparty default risk module to better reflect the real risk to which the companies are exposed. If infrastructure debt remains within the spread risk module, spread calibrations would have to be reduced by a significant factor in order to correctly reflect the better recovery rates exhibited by infrastructure compared to other corporate bonds.
- While a hold to maturity strategy is often the intention of insurers when investing in infrastructure, it should not become an obligation and condition for a tailored prudential treatment. Insurers should be allowed to dispose of assets when it makes sense for them to do so for reasons such as good risk management, target and strategic asset allocation, policyholder benefit.
- Insurers' exposure to infrastructure is limited. While it is likely to grow in the future, there are important barriers to significant growth, including the lack of significant levels of available infrastructure assets. If supervisors have concerns regarding an excessive allocation to infrastructure, then the aim should be to review the calibration approach over time instead of using such concerns to justify limited action now.
- There are many areas of the Solvency II framework where EIOPA has had to use expert judgement because of the lack of historical data. For some areas of infrastructure, such as defaults and recoveries, there are studies to draw on. In other areas, such as correlation and equity risk, economic rationale may need to be relied on, supported by modelling/anecdotal evidence where available.
- The infrastructure markets remain local markets, with local specificities in product disclosure. While Insurance Europe agrees that more standardisation could encourage cross-border investment, this should not be a legislative objective of prudential regulation.

General comments:

Availability of assets is crucial for the significant role that insurers play as Europe's largest institutional investors. What can make infrastructure assets interesting for insurers is their low correlation with financial markets' performance, their ability to match long-duration liabilities and their attractive yields.

The industry has in the past highlighted the need for an established schedule/pipeline of viable infrastructure projects for investment. From this perspective, the EU Investment Plan is regarded by the industry as an initiative that has the potential to encourage more institutional investment and therefore contribute to European growth in the coming years.

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However, even if the supply of, and access to, suitable projects is solved, the unnecessarily high capital charges relative to true risks will continue to create major barriers to investment. There will be a need for companies to develop suitable expertise for infrastructure investment or find ways to access expertise. If infrastructure grows into a significant and accessible asset class, expertise will become more available over time.

Solvency II does not sufficiently recognise how asset risk is significantly reduced because of the combination of long-term assets backing long-term liabilities which significantly diminish or even eliminate risk of losses on forced sales. This can have an impact on both equity and debt type long-term investments. For example, in the case of bonds, default risk is another aspect of credit risk which, in many cases, is the most or the only relevant risk. This is acknowledged under Article 13 (32) of the Solvency II Directive* and also in the solutions agreed in Omnibus II**. Ignoring this difference will lead to wrong calibrations and will severely adversely impact long-term investments.

Insurance Europe appreciates the challenging circumstances under which EIOPA is conducting its work on infrastructure. However, given these circumstances and the tight deadlines, Insurance Europe cannot provide an extensive amount of new data even though EIOPA asks in several places of the discussion paper for data that allows for a calibration or that can serve as evidence for conclusions. The following answers are often rather based on what Insurance Europe believes to be an economic approach and conclusions are sometimes established on comparisons between different asset classes.

There are many areas of the Solvency II framework where EIOPA has had to use expert judgement because of the lack of historical data. For some areas of infrastructure, such as defaults and recoveries, there are studies to draw on. In other areas, such as correlation and equity risk, economic rationale may need to be relied on, supported by modelling/anecdotal evidence where available.

Insurance Europe would like note that it will continue to work with its members on specific recalibration proposals in the coming weeks, which it will submit to EIOPA as soon as available.

**) credit risk means the risk of loss or of adverse change in the financial situation, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which insurance and reinsurance undertakings are exposed, in the form of counterparty default risk, or spread risk, or market risk concentrations*

***) According to the Omnibus II post-trilogue agreement: Where insurance and reinsurance undertakings hold bonds or other assets with similar cash-flow characteristics to maturity, they are not exposed to the risk of changing spreads on these assets (Recital 17b).*

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Answer to question 1:

Currently the valuation is a key issue which also creates disincentives for investments. Valuation creates significant balance sheet volatility and need for buffers. This cannot be addressed here and should be taken into account as part of future Solvency II reviews, but it should be recognised that it makes the issue of capital requirements even more important. While the matching adjustment addresses the artificial volatility of Solvency II valuation, its application is very restricted. The volatility adjustment will only address this issue to a limited degree.

Furthermore, very prescriptive criteria for infrastructure investments that EIOPA considers in its discussion paper have the potential to disincentivise insurers from investing in the future. Insurance Europe believes that EIOPA should recognize the undertaking specific processes for investment decisions as reflected in the principle-based framework of the prudent person principle. A narrow framework for infrastructure investments should therefore be avoided.

Non-Solvency II requirements include lack of projects and lack of accessibility of projects. For example, there should be an adequate number of economically viable projects available in order to:

- Justify the build-up of expertise within insurance companies.
- Ensure diversification in the allocation of projects.
- Support the development of related insurance products.

An additional regulatory obstacle for infrastructure equity investment is the existing **regulation on unbundling** in the third energy package. Strict separation of energy production and energy transportation results in an "either or" conflict and therefore 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.

The specificities of infrastructure projects must also be recognized from an **accounting perspective** in order to avoid any negative side impact of current IFRS developments towards long term investments.

- Investing in infrastructure projects is an important part of the long-term asset-liability-management strategy of an insurer.
- The IASB "IFRS 4 Insurance Contracts Phase II" project (covering insurance liabilities) is nearing finalisation and it is absolutely necessary that it interacts appropriately with IFRS 9 (covering financial assets) and accurately reflects insurers' long-term business model. This will avoid disincentives for long-term investment.

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Question 2

It is currently assumed in the Solvency II standard formula that infrastructure investments behave like any other exposures to eg corporate bonds or general equity. This is despite the fact that infrastructure investments have shown higher recovery rates and lower instances of default than other investments*, which this justifies more tailored approach to measuring underlying risks and implicit capital requirements.

Infrastructure assets are attractive for insurers because they represent a good source of diversification and yield for insurers' portfolios. Infrastructure projects will only be financed if providers of both equity and debt financing are found. Insurers are interested and invest in both forms of investment and preference for one type of instrument over another is company specific and based on the nature of liabilities, while also depending on other factors such as a company's areas of experience, risk appetite, availability, expected yields.

Insurance Europe therefore believes that a tailored treatment should be investigated for infrastructure for all investment vehicles.

**) See J.P. Morgan Asset Management, Global Real Assets (2013): A case for Core Infra-structure, Moody's Annual Default Study: Corporate Default and Recovery Rates, 1920-2013, published in February 2014 and Moody's report: Default and Recovery Rates for Project Finance Bank Loans, 1983-2013, published in February 2015*

Question 3

The current allocation of insurers to infrastructure assets is around 1% and, while it is likely to grow in the future, there are significant limitations to excessive growth, including the lack of significant levels of available infrastructure assets. So EIOPA should not take an unnecessarily restrictive approach in tailoring the treatment of infrastructure in Solvency II, focused on liquidity and forced sales of infrastructure. Instead, it could consider monitoring exposures in the coming years and proposing actions, should actual, real concerns emerge.

Solvency II encourages asset-liability matching and therefore insurers are already incentivised to buy assets to match their liabilities. Matching of 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.

Insurers are actually often interested in the illiquid and long-term nature of infrastructure investments, matching liabilities of similar nature. Illiquid assets also provide access to illiquidity premia that enhances portfolio performance, for the benefit of policyholders.

The qualitative requirements of Solvency II apply and companies are in fact required to reflect on liquidity risk in their written policy on risk management and in their ORSA reports. Therefore, supervisors will be able to assess the liquidity plans of insurers regarding their ability to avoid fire-sales of illiquid long-term investments like infrastructure. This fact

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	<p>has also been recognized in the application procedure for the volatility adjustment in the British market. Therefore, any further requirements in order to address liquidity risk are therefore not necessary.</p> <p>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.</p> <p>It should not be forbidden for insurers to sell infrastructure assets when it is appropriate for them to do so from a risk-management/optimal capital allocation perspective. It is therefore not sensible to prohibit disposal of assets.</p> <p>Moreover, EIOPA should adequately reflect the business model of insurers that is to a much lesser extent than that of banks exposed to liquidity risks.</p>	
Question 4	Insurance Europe does not believe that there should be discrimination between debt instruments with and without ECAI rating. Whether a project complies with the definition of infrastructure should be based on the nature of the project itself, not on whether the debt is rated or not. It should also be noted that a considerable part of the projects supported by the EFSI are likely to be unrated.	
Question 5	Insurance Europe does not believe that the project finance definition should be used for the purpose of Solvency II identification of infrastructure. However, Insurance Europe agrees that elements of it are used, but it must be ensured that the wording is incorporated in an appropriate way. In conclusion, a tailored treatment for the asset class as defined under Q7 should be proposed by EIOPA to the European Commission.	
Question 6	Insurance Europe is not aware of any other legal definition.	
Question 7	<p>Insurance Europe proposes an approach that includes:</p> <ul style="list-style-type: none"> ■ A definition of infrastructure as an asset class – in line with point (a) of the Discussion Paper. ■ A recital illustrating types of infrastructure investments that would be covered by the definition – in line with point (b) of the Discussion Paper. ■ A definition of 'long-term infrastructure exposures' that would receive a tailored prudential treatment – in line with point (c) of the Discussion Paper. <p><u>A definition of infrastructure assets</u></p> <p><i>xx. 'Infrastructure assets' 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.</i></p>	

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This definition has the advantage that it does not leave any relevant infrastructure out and fits best the purpose of supporting the goals of the EU Investment Plan.

A recital illustrating types of infrastructure investments that would be covered by the definition:

The calibration of the equity and counterparty risk for long-term infrastructure exposures should reflect that this asset class has predictable cash-flows and a low correlation with other asset classes. The asset class should capture the broad range of assets such as 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 public authority. These characteristics result in common financial features that are predictable, steady and long-term cash flows.

A tailored treatment should apply to long term infrastructure exposures, which are infrastructure assets that fulfill the following characteristics:

- (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 collective of investors have a substantial degree of control over the assets as long as the asset is not controlled by a public institution.
- (d) The primary source of payments to the investors is the income generated from the assets being financed or by revenues from public sector institutions or are contractually specified.
- (e) The initial maturity of the project at issuance is at least 5 years.
- (f) 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, construction (EPC) contract.
- (g) The assets are located in member state of the Union or the OECD or country specific risk is effectively

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	<p>mitigated by guarantees or insurance.</p> <p>No further criteria should be developed in order to distinguish good from bad infrastructure investments. Solvency II already provides for very comprehensive qualitative requirements under its pillar 2. For a change of the structure in the standard formula, the requirements of pillar 2 should therefore not be 'reinvented'.</p>	
Question 8	Please refer to the answer to Q7.	
Question 9	Please refer to the answer to Q5.	
Question 10	<p>Insurance Europe does not support an approach that completely excludes some infrastructure sectors from the scope of the calibrations' review. The compliance with the definition of infrastructure should be analysed for the project as such, which only partly depends on the specific sector.</p> <p>Please also refer to the answer to Q7.</p>	
Question 11	Insurance Europe does not believe that any further criteria apart from the definition proposed under Q7 should be developed in order to distinguish 'good' from 'bad' infrastructure investments. Solvency II already provides for very comprehensive qualitative requirements under its pillar 2. For a change in the structure of the standard formula, the requirements of pillar 2 should therefore not be 'reinvented'.	
Question 12	<p>It is currently assumed in the Solvency II standard formula that infrastructure investments behave like any other exposures to eg banking bonds or general equity and that insurers act as traders with respect all asset classes currently captured under the market risk module. This is despite the fact that infrastructure investments are typically illiquid, do not have a price in the market and have shown higher recovery rates than other investments which justify the need for a more tailored approach to measuring underlying risks and implicit capital requirements.</p> <p>Insurance Europe believes that the characteristics proposed in the definition under Q7 ensure that the assets have a different risk profile than implied in the standard formula. More specifically, the characteristics (a) – (d) in the definition of long-term infrastructure exposures ensure that the investment has a different risk profile than ordinary corporates or listed equities which were used for the standard formula calibration. The characteristic under (e) proves the long-term nature of the investment which is consistent with the goals of the EU Investment Plan and the fact that insurers will not be exposed to short-term market volatility. Finally, the points (f) and (g) address operational risk and political environment.</p> <p>While it may be true that there are still exposures of different credit quality in the asset class as proposed in the response to Q7, Insurance Europe believes that no further refinement is necessary. In the design of the standard</p>	

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	<p>formula, there needs to be a reasonable balance between a risk-based approach and simplicity. The fact that an asset class can be heterogeneous with respect to risk profile is already recognised under Solvency II and addressed by qualitative requirements under pillar 2. As an example, in the asset class of listed equity (type 1), there is a broad range of different exposures with varying risk profiles. As it is accepted for this asset class that no further refinement is needed, Insurance Europe believes that infrastructure does not need a further refinement, due to the existing requirements for risk management.</p> <p>Insurance Europe also points out that Moody's data for project finance* does not use any further criteria for their data sample. A tailored treatment is therefore justifiable for project finance without further restrictions.</p> <p><i>*) Moody's report: Default and Recovery Rates for Project Finance Bank Loans, 1983-2013, published in February 2015</i></p>	
Question 13	<p>The CRR for credit risk and Solvency II follow a different logic and have different priorities in accordance with the risk profiles of banks and insurers respectively. Under Basel II's IRB approach, which is more sophisticated than the standardised approach, the list of slotting criteria is used for the credit assessment of specialised lending exposures only, where the credit institution is not able to estimate PD and LGD. Each of the obtained sub-categories is assigned a different risk-weight. Additional complexity for the infrastructure asset class from the IRB approach is justified for the Solvency II standard formula which corresponds rather to Basel II's standardised approach.</p> <p>As pointed out by EIOPA, the RTS from EBA is not yet finalised nor in public consultation. Insurance Europe can therefore not comment on the content. However, Insurance Europe strongly objects to committing the European insurance sector to standards that will be developed by EBA in the future.</p>	
Question 14	<p>The list of slotting criteria in the Basel II paper is long, designed for internal ratings and therefore practically not feasible under the standard formula. In fact, in light of the Solvency II pillar 2 requirements, it is redundant to apply the list. For example, elements in the Basel II list such as financial strength, political and legal environment, transaction characteristics, security package, strength of sponsor are, to a large extent, considerations under the prudent person principle in Solvency II.</p> <p>Insurance Europe does therefore not consider the list useful for Solvency II.</p> <p>Please refer also to answer to Q13.</p>	
Question 15	<p>Insurance Europe does not believe that the criteria should be adopted under Solvency II.</p> <p>Please, refer also to answer to Q13 and Q14.</p>	

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Question 16	Insurance Europe does not believe that apart from criteria outlined in the answer to Q7 any further criteria should be developed in order to distinguish between good from bad infrastructure investments. There are better and worse assets within every asset class: the purpose of capital requirements is to differentiate within the asset class between, eg credit quality steps; if for a specific asset a credit quality step is not available, then a suitably conservative approach should be taken.	
Question 17	Insurance Europe objects to any additional criteria. Please refer to answer to Q7.	
Question 18	Insurance Europe objects to any additional criteria. Please refer to answer to Q7.	
Question 19	Insurance Europe objects to any additional criteria. Please refer to answer to Q7.	
Question 20	<p>There are various risk-mitigation tools, including those listed below. Such elements will anyway be captured in the credit assessment process within the asset class. The need for risk-mitigation and its effectiveness depend on the nature of the project.</p> <p>Examples of risk mitigation techniques include:</p> <ul style="list-style-type: none"> ■ Portfolio diversification – at overall portfolio level, but also within a segment – for which an appropriate deal flow and deal size are needed. ■ Hedging and contractual agreements. <ul style="list-style-type: none"> ■ For example, in the case of greenfield projects, a well-defined engineering, procurement, construction (EPC) contract can efficiently mitigate risks. A turnkey EPC is a common form of project handling in PPP, where a general contractor commits to supply a plant or building to the client, usually at a fixed price and by a certain deadline (contract penalty included). ■ A well-defined permitting process or obtaining all permits before financial close. ■ Completion guarantees from sponsors with low credit risk. ■ Involving a contractor with a good financial strength and track record in similar projects. ■ Another type of risk mitigant can be contractual agreements (power purchase agreement) where price and quantity of electricity purchased are predetermined. 	
Question 21	Please refer to the answer to question 20.	
Question 22	Existence of credit enhancement or guarantees within a product should not be a pre-condition of a tailored treatment.	

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	Such parameters will be reflected in the characteristics of the product, such as credit rating, yield, etc. Apart from that, it is not clear what it is meant by "a sufficient level of protection". The existence of credit enhancement and/or guarantees is reflected in the parameters of the product, such as level of risk premiums and, if available, the assessment of credit quality. There is therefore no need to define further criteria.	
Question 23	No comments.	
Question 24	Insurance Europe does not see the relevance of this element in the identification and recalibration discussion.	
Question 25	Insurance Europe does not see the relevance of this element in the identification and recalibration discussion.	
Question 26	Insurance Europe does not see the relevance of this element in the identification and recalibration discussion.	
Question 27	Insurance Europe does not see the relevance of this element in the identification and recalibration discussion.	
Question 28	Insurance Europe does not see the relevance of this element in the identification and recalibration discussion.	
Question 29	No comments.	
Question 30	No, it is not. The refinancing risk is not specific to infrastructure debt financing and is already handled in the risk management policy of the insurers. The debt investor needs know what would be the impact of such refinancing risk on its ALM and value it properly before making any investment decision. As a matter of fact, the refinancing risk should not be taken into account in a tailored calibration of the Solvency II capital charge for infrastructure debt investments.	
Question 31	As pointed out by a recent publication from J.P. Morgan*, prepayment risk hardly has any significance for infrastructure investments. Furthermore, such risks are already adequately covered under existing pillar 2 regulations (especially liquidity management). *) <i>J.P. Morgan Asset management, 2012, Infrastructure debt strategy - prepayment/refinancing risk, http://cameronmckenna.jpmorganassetmanagement.co.uk/Institutional/_documents/JPM5396-Infrastructure-debt-strategy.pdf</i>	
Question 32	Such a condition cannot be made operational. Insurance Europe believes that this is a good example of a criterion that in practice would be very difficult to verify compliance with and should be part of the identification	
Question 33	Given the variety of potential infrastructure investment projects, it is natural that certain criteria are not easily verifiable or quantifiable. Solvency II already has elements regarding the responsibility for insurers themselves to prudently assess the risks of their investments rather than to rely on fixed quotas or risk metrics. The assessment of an insurer that a certain set of criteria (eg 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	Insurance Europe's proposals below for alternative charges are the following: ■ For infrastructure equities (see Q38, 40 and 41 for more details):	

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	<ul style="list-style-type: none"> ■ Listed infrastructure equities should remain type 1. ■ Unlisted infrastructure equities should become a new sub-module of market risk, with a 22% charge and a zero-correlation with other market risk sub-modules. ■ For infrastructure debt: <ul style="list-style-type: none"> ■ Insurance Europe recommends a treatment under the counterparty default risk module to better reflect real risk to which companies are exposed. ■ If infrastructure debt remains within the spread risk module, spread calibrations would have to be reduced by a significant factor in order to correctly reflect the better recovery rates exhibited by infrastructure compared to other corporate bonds. 	
Question 35	<p>There is no reason that the discussion on infrastructure should have any impact on the requirements for the use of an internal model. Any special requirements for internal models on infrastructure would not encourage investments in this asset class, but could instead discourage investments from companies with well-established and tested internal models that would need to change to adapt to potentially new, prescriptive requirements. This would be particularly disruptive at a time when companies are in the process of submitting internal model applications.</p> <p>Insurance Europe advocates for changes to the standard formula, to better reflect the risk of infrastructure assets.</p> <p>Insurance Europe welcomes that the Commission's call for advice focuses on how it would be appropriate to amend the Solvency II standard formula. The solvency capital requirement can either be calculated by the standard formula or – completely or partly – by an approved internal model. Internal models best capture the individual risks of an undertaking. However, many undertakings still rely on the standard formula. Therefore a solution based on internal models would not address the issue identified.</p> <p>Therefore, 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. Full and partial internal models remain an option for companies wishing to develop and use them.</p>	
Question 36	No comments.	
Question 37	No comments.	
Question 38	For listed infrastructure equities, Insurance Europe believes 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.	

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	<p>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.</p> <p>Indeed, unlisted equity investments in infrastructure are not subject to short-term trading and have to be valued based on their future net returns. Under Solvency II, however, 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.</p> <p>Insurance Europe does not believe this could be solved by moving them to the type 1 category. Instead, a new sub-module should be created in the market risk module, corresponding specifically to unlisted equity infrastructure risk and assigned a risk factor set at a prudent level of 22%*.</p> <p>This would be in line with the treatment applied to equity investments of a strategic nature and Insurance Europe believes this makes sense since those investments exhibit similar characteristics: as said above unlisted equities are significantly less volatile than other equities, fulfilling the criterion in Article 171(a) of the Solvency II Delegated Act. Additionally, Insurance Europe believes that it would be a strategic decision from insurers to invest in infrastructure, and that they would do it "for a long period" as stated in Article 171(b)(i).</p> <p>In terms of correlations with the other types of equity, as stated above, unlisted infrastructure equities are nearly uncorrelated with both listed infrastructure and global equity**: in this JP Morgan study historical correlation is only of 10% between private infrastructure and global equities. Therefore, Insurance Europe proposes that there is a zero correlation between this new sub-module and the equity risk sub-module. Likewise, Insurance Europe believes the correlation should be zero between this new sub-module and the other types of market risks (interest rate risk, spread risk, etc) since unlisted infrastructure equities are hardly correlated with market movements.</p> <p><i>*) Similar proposal was referenced as background note in EIOPA's final paper on the calibration of long-term investments (Blanc-Brude, F. (2013): Towards Efficient Benchmarks for Infrastructure Equity Investments. EDHEC Risk Institute</i></p> <p><i>***) See J.P. Morgan Asset Management, Global Real Assets (2013): A case for Core Infra-structure.</i></p>	
Question 39	No comments.	
Question 40	<p>As stated in Insurance Europe's response to Q38, it believes that infrastructure listed equities have a very similar profile to type 1 equities (and a 90% correlation with them). Hence they should remain treated as type 1.</p> <p>On the other hand, as explained above, unlisted infrastructure equities should get the same capital charges as equity investments of a strategic nature and be treated in a separate sub-module.</p>	
Question 41	Please refer to Insurance Europe's response to Q38.	

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	<p>The returns of unlisted infrastructure exhibit much lower volatility and are nearly uncorrelated with both listed infrastructure and global equity*. Therefore, they should be treated in a new sub-module of the market risk module, with a zero correlation towards the other types of equities and market risks (interest rate risk, spread risk, etc).</p> <p><i>*) See J.P. Morgan Asset Management, Global Real Assets (2013): A case for Core Infra-structure.</i></p>	
Question 42	<p>As the infrastructure asset class is mainly illiquid, EIOPA should not pursue to base a calculation on mark-to-market data. There is more data on credit performance of infrastructure debt (eg from Moody's or S&P). Insurance Europe believes that the calibration should therefore be based on a comparison of the credit performance of infrastructure debt with other asset classes.</p>	
Question 43	<p>Yes. JP Morgan's 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.</p> <p>Besides, it is also important to note that ratings for total infrastructure securities have been more stable throughout the study period and were notably more stable than those for non-financial corporate issuers in the 2008-2009 financial crisis and recession. As explained in a Moody's report published in September 2011, "infrastructure issuers tend to enjoy open and welcoming capital markets, and rarely experience trouble raising the necessary capital to meet their investment needs." **</p> <p><i>*) See J.P. Morgan Asset Management, Global Real Assets (2013): A case for Core Infra-structure.</i> <i>***) See Moody's Study: The Great Credit Shift - Infrastructure Finance Post Crisis, published in September 2011 and Moody's Infrastructure Finance Default Study published in March 2015.</i></p>	
Question 44	<p>Insurance Europe believes that the counterparty default risk module is an avenue that should be considered as it best reflects the actual risk exposure that such investments generate. This 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.</p> <p>If infrastructure debt remains within the spread risk module, spread calibrations would have to be reduced by a significant factor to reflect higher recovery rates compared to normal corporate debt - as specified in more details in the response to Q45.</p>	
Question 45	<p>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. 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 (i) the recognition of the specificities of infrastructure</p>	

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	<p>and implicit lower investment risk, as well as for (ii) the recognition of the low correlation between infrastructure risk and other asset risks.</p> <p>The fact that there is an important difference between recovery experience of infrastructure debt vs normal corporate debt should be reflected and it is supported by the following loss-given-default finding:</p> <ul style="list-style-type: none"> ■ 30% was the value of loss given default for the infrastructure bonds or loans based on the Moody's study "Default rates and recovery rates for project finance bank loans 1983-2013" for the infrastructure and power industry sector. ■ 55% appears to be the loss given default of a AA bond in the QIS5, which is in line with loss given default for AA to BB bonds in a Moody's study* which are all between 55% to 58%. <p><i>*) See Moody's Annual Default Study: Corporate Default and Recovery Rates, 1920-2013, published in February 2014</i></p>	
Question 46	<p>Insurance Europe strongly objects to any additional requirements for insurers to hold their assets until maturity. The risk management requirements of Solvency II apply, including those on asset-liability management, liquidity risk management, investment risk management and the prudent person principle. Companies are required to reflect on these issues in their written policy on risk management and in their ORSA reports. Any further requirements in order to address asset-liability management, liquidity risk management, investment risk management or the prudent person principle are therefore unnecessary and will needlessly increase the complexity of regulation.</p> <p>Furthermore, the interest rate risk sub-module of Solvency II encourages asset-liability matching and therefore insurers are already incentivised to buy assets that match their liabilities. Matching of 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 their lifetime.</p> <p>It should not be forbidden for insurers to sell infrastructure assets when it's appropriate for them to do so from a risk management/optimal capital allocation perspective. There may be very good reasons to sell an asset, even if the insurer has a clear buy and hold policy. For instance, a change in investment strategy could lead to a sale decision that would have no influence on the company's solvency status.</p>	
Question 47	Insurance Europe suggests applying an adjustment factor for SME loans as well.	
Question 48	Insurance Europe suggests covering SME loans in the counterparty default risk module as well.	
Question 49	Insurance Europe strongly supports the recalibration of infrastructure debt in the counterparty default risk module. Such an approach would appropriately reflect the nature of the risk that insurers are exposed to, since they are not exposed to forced sales. Treating infrastructure debt in the counterparty default risk module would base the capital	

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	<p>charge on default and recovery rates, which is in line with available data.</p> <p>Regarding evidence on why infrastructure is different, the Moody's study* allows drawing conclusions on the following aspects:</p> <ul style="list-style-type: none"> ■ Compared to corporate bonds, infrastructure debt shows much higher recovery rates: 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 between 60% and 80% while corporate bonds showed ultimate recoveries from 28% (subordinated bonds) to 63.5% for senior secured bonds**. ■ It's worth mentioning that a Moody's study already shows that globally infrastructure security ratings have been relatively stable, when compared with Non-Financial Corporate Issuers. *** <p>These findings could serve as a starting point for a calibration in the counterparty risk. It is then possible to provide a calibration table with capital charges depending on credit quality steps. The calibrations could for simplicity be based on the long-term term credit performance (eg 10 year recovery rates). Such a calibration would deliver conservative results compared to a 1-year time horizon approach.</p> <p>The default risk does depend on maturity; however, in order to simplify the calibrations one option to consider would be to base the calibrations on a long-term term debt (eg 15 or 20 years) rather than vary the capital charge by maturity. While this would be potentially rather conservative for short-term durations, the impact should be relatively limited because most infrastructure debt will tend to be long-term.</p> <p><i>*) See Moody's Annual Default Study: Corporate Default and Recovery Rates, 1920-2013, published in February 2014</i> <i>***) See Moody's Annual Default Study: Corporate Default and Recovery Rates, 1920-2013, published in February 2014</i> <i>***) See Moody's Study: The Great Credit Shift – Infrastructure Finance Post Crisis, published in September 2011 and Moody's Infrastructure Finance Default Study published in March 2015.</i></p>	
Question 50	<p>Insurance Europe believes it would make sense to treat infrastructure in a similar way as other type 2 exposures in the counterparty default risk module since infrastructure presents an economic substance which is similar to mortgages, eg with reliance on collateral and the cash flows arising from the project. This treatment could still be seen as conservative since in the case of infrastructure there is not as much dependence to the financial strength of the borrower.</p> <p>From a practical point of view the treatment similar to type 2 would be easier since it only requires the calculation of the loss given default which is possible for both rated and unrated projects.</p>	
Question 51	<p>Non-existence of an ECAI is not indicative of non-quality. Unrated debt should be included in the analysis next to rated debt. Excluding unrated debt would be unjustified from a risk perspective and can significantly reduce the number of</p>	

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	<p>investments that would qualify for a tailored prudential treatment.</p> <p>Current pillar 2 requirements (investment risk management policy, the prudent person principle, ORSA etc) are sufficient to ensure an adequate quality of unrated infrastructure investments. It should also be noted that no additional requirements are imposed for unrated corporate debt; any additional criteria for unrated infrastructure would therefore be inconsistent with the prior approach adopted in the Delegated Acts.</p> <p>Limiting a tailored treatment to only 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. In case an external rating by a recognised agency does not then the investor's own credit assessment should be used.</p>	
Question 52	<p>Insurance Europe is concerned about EIOPA's very prescriptive areas for attention which ignore the already existing requirements of Solvency II's pillar 2. Indeed, these listed areas of attention (having a comprehensive understanding, performing an adequate due diligence, written policies, internal reporting) are already covered extensively under the existing regulation, such as guidelines on system of governance, in articles 259, 260 and 261 of the Delegated Acts and by the requirements regarding the ORSA. These existing pillar 2 regulations are also the reason why other illiquid non-routine investments such as private equity do not have specific risk management requirements either.</p>	
Question 53	No comments.	
Question 54	Modelling is undertaking-specific and EIOPA should not envisage the development of a too prescriptive framework that could violate the principles-based approach of Solvency II.	
Question 55	Availability of prospectus information should be encouraged through different policy measures and not through prudential regulation.	
Question 56	<p>Availability of product information can ease insurers' access and diminish efforts that are needed for infrastructure investment decision-making. The prudential treatment of infrastructure investments should however not become contingent on the availability of, for example, reporting templates. 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.</p> <p>Availability of information can therefore be managed by industry initiatives, rather than being imposed by prudential regulation. Any pre-defined list imposed by Solvency II is unlikely to take into account the specificities of particular infrastructure projects. Current Solvency II pillar 2 regulation already sufficiently requires information availability. In fact, the already existing pillar 2 requirements are the reason why many other (illiquid) asset classes, such as</p>	

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	corporate loans, private equity etc. do not carry specific information requirements under Solvency II.	
Question 57	<p>The infrastructure market remains a local market, with local specificities in product disclosure. While Insurance Europe agrees that more standardisation could encourage cross-border investment, this should not be an objective of prudential regulation.</p> <p>Please also refer to the answer to Q56.</p>	
Question 58	<p>Standardised provision of information is a product feature and should not be part of prudential regulation. Other policy measures can be designed to encourage standardisation and transparency, this is however not the purpose of prudential regulation for investors.</p> <p>Please also refer to the answer to Q56.</p>	
Question 59	<p>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.</p> <p>Insurers need detailed information on every project in order to perform risk analysis and to assess the risk /reward profile of each investment proposal. More standardisation and transparency can make it easier for insurers to perform the necessary pre-investment analysis of opportunities.</p> <p>While standardisation can help increase attractiveness of specific projects, it remains a market issue and should not be used as a criterion for a tailored prudential treatment.</p> <p>Please also refer to our answer to Q56.</p>	
Question 60	<p>As noted above, standardisation can play a role in increasing the attractiveness of a given project and, implicitly, its tradability. Insurance Europe believes however that tradability and liquidity should not be an objective pursued by prudential rules, but rather a market mechanism. Moreover, contract standardisation can raise a lot of issues in practice and it may be dangerous to start from a standardised documentation for such heterogeneous asset class such as infrastructure.</p>	