Comments Template on EIOPA-CP-16-005 Consultation Paper on the request to EIOPA for further technical advice on the identification and calibration of other infrastructure investment risk categories i.e. infrastructure corporates		Deadline 16.May.2016 23:59 CET
Company name:	The Investment Association	
Disclosure of comments:	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments on this CP should be treated as confidential, by deleting the word Public in the column to the right and by inserting the word Confidential.	Public
	Please follow the instructions for filling in the template: ⇨ Do **not** change the numbering in column "Reference". ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific paragraph numbers below. ○ If your comment refers to multiple paragraphs, please insert your comment at the first relevant paragraph and mention in your comment to which other paragraphs this also applies. ○ If your comment refers to sub-bullets/sub-paragraphs, please indicate this in the comment itself. **Please send the completed template to CP-16-005@eiopa.europa.eu, in MSWord Format, (our IT tool does not allow processing of any other formats).** The paragraph numbers below correspond to Consultation Paper No. EIOPA-CP-16-005.	
Reference	**Comment**	
General comments	The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients. Our purpose is to ensure investment managers are in the best possible position to: • Build people's resilience to financial adversity • Help people achieve their financial aspirations • Enable people to maintain a decent standard of living as they grow older	

- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs. The UK is the second largest investment management centre in the world and manages 37% of European assets.

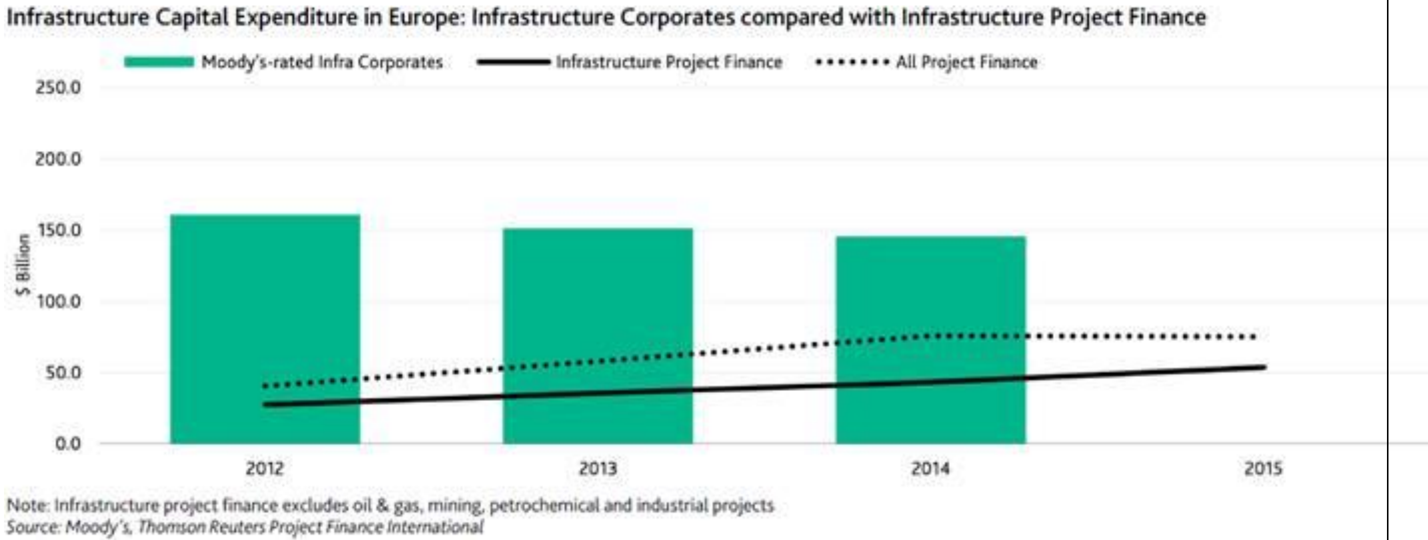
The Investment Association welcomes the opportunity to respond to EIOPA's consultation paper on the identification and calibration of infrastructure corporates.

Despite evidence in the Moody's study on infrastructure default and recovery rates (cited on p.13 of this consultation paper) which indicated that there is the same risk for corporates as for private finance, with the drivers of recovery being strong covenants and limited ownership of assets, Solvency II infrastructure corporates are currently excluded from the qualifying framework.

The Investment Association believes that the exclusion of infrastructure corporates:

- Could incentivise a private equity model of infrastructure financing versus a corporate model, which is unwelcome; and
- Would considerably constrain the pipeline of infrastructure projects that insurers and other investors could invest in.

Infrastructure corporates represent an important share of the overall infrastructure investment universe. Moody's estimates that "... *in Europe over the period 2012-14, [we] estimate that total capex by Moody's-rated infrastructure corporates was more than 4x the combined capital value of the infrastructure project finance transactions (whether rated or not) that reached financial close during the period …*"



Source: Moody's, *Bridging $1 trillion infrastructure gap needs multi-pronged approach, 24 February 2016*

The Investment Association is also concerned about the potential for cliff-edge effects were an infrastructure project to become an infrastructure corporate over time. This could lead to capital charges changing overnight as a result of a change in legal setup, which could in turn make investors forced sellers as the increased capital requirements would result in these infrastructure corporates no longer being considered suitable investments.

The Investment Association would therefore welcome the inclusion of infrastructure corporates within the Solvency II qualifying framework.

In our response we highlight several areas of concern we have with the existing analysis, and suggest changes that could aid in ensuring that the prudential treatment of infrastructure corporates

	is line with their risk profile.
	
	In particular, we note concerns that:
	
	• Conclusions drawn from data on listed entities may not apply directly to unlisted entities (which make up a large part of investors' portfolios) given the difference in structure between the listed and unlisted entities.
	• The current definition of "infrastructure corporate" would exclude:
	    ○ Infrastructure assets operating in OECD countries that are not in the EEA;
	    ○ Telecoms infrastructure, even where there is a strong social benefit and it is possible to separate infrastructure revenues from consumer goods revenues;
	    ○ Energy storage facilities.
	    ○ Waste management services.
	    ○ Infrastructure corporates with more than a *de minimis* amount of revenue from ancillary business.
	• The requirement for a five-year track record for unrated infrastructure corporates is potentially overly restrictive, particularly given the large amount of infrastructure corporate debt that is unrated.
	
	The Investment Association welcomes further discussion of any of the points raised in our response.	

Section 1.1.		
Section 1.2.		
Section 1.3.		
Section 1.4.		
Section 1.5.		
Section 2.		

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Section 3.		
Section 4.		
Section 5.1.		
Section 5.2.		
Question 1.	**a) Do you agree that in the absence of publicly available data on unlisted infrastructure assets, the data on listed entities analysed by EIOPA are an appropriate proxy?** The Investment Association understands that there is a lack of available data regarding unlisted infrastructure assets. However, conclusions drawn from data on listed entities may not apply directly to unlisted entities, given the differences in structure between the two. This is because listed market entities would be subject to market volatility which may not be linked to the risk attached to the underlying investment. Further, investors investing in private unlisted debt are more likely to benefit from additional protections such as stronger security packages or covenant sets versus listed debt. Investors in unlisted equity may benefit from controlling shareholders rights that offer protections that may not be available to those investing in listed equity. Finally, basing an analysis solely on market data therefore risks not capturing a large portion of the infrastructure investment universe and giving the impression that infrastructure corporates are riskier than they actually are. **b) If not, please provide a comprehensive justification and supporting evidence, including data, International Securities Identification Numbers (ISIN) codes and examples.** The list of analysed entities does not include a number of corporates which The Investment	

	Association considers would contribute to EIOPA's analysis. In particular, it lacks coverage of rolling stock providers and social housing, and leaves out significant water providers and certain smaller European airports.	
Section 5.3.		

Section 6.1.	Other suitable indices would include:
	
	• UBS Global Infrastructure & Utilities Index, comprising:
	  ○ The UBS Global Infrastructure Index, tracking the performance of non-utility related global listed infrastructure
	  ○ The UBS Global Utilities Index, tracking the performance of global utility companies (with the exception of sub-sector generation utilities)
	• UBS Global 50/50 Infrastructure & Utilities Index
	  ○ The infrastructure sector and utilities sector each have 50% weighting in terms of free-float market capitalisation under this index, which removes the skew towards utilities found in the UBS Developed Infrastructure & Utilities Index. Constituents of the index are all listed in developed markets.
	• NMX30 Infrastructure Global Natural Monopoly Index (ISIN: CH0032212869)
	  ○ Offers investors exposure to the 30 largest companies in the infrastructure sector worldwide.
	  ○ A regional sub-index focusing on Europe (ISIN: CH0032213941).
	• FTSE Macquarie Global Infrastructure:
	  ○ Calculated by FITSE to reflect the stock performance of companies worldwide within the infrastructure industry, principally those engaged in management, ownership and operation of infrastructure and utility assets.	

Section 6.2.		
Section 6.3.		

Section 6.4.		
Section 6.5.		
Section 7.1.		
Section 7.2.		
Section 7.3.		
Section 7.4.		
Section 7.5.		
Section 8.1.		
Section 8.2.		
Question 2.	**a) Do you agree with the assessment of the risks of telecom investments as evidenced by the historical price data?** Telecoms have a high social benefit. Certain broadband or smart-metering businesses, for example, could be considered to meet the definition of infrastructure, and are financed by investors on that basis. It is important that any criteria do not exclude such businesses. In general, The Investment Association would recommend that EIOPA avoid introducing a granular capital charge structure for different forms of infrastructure investment. Such a system would inevitably be extremely complex and risk constraining investment in certain infrastructure assets, even where there is a strong social benefit. **b) Are there any segments within the telecom industry that are safer than other segments, which deserve further granular analysis? If yes, please provide a comprehensive justification and supporting evidence including data, ISIN codes and examples.** While The Investment Association recognises that there are challenges as to how to separate regulated infrastructure activities (such as cable provision) from non-regulated business (such	

as phone contracts), it should be noted that there are Issuers who operate principally as providers of telecom infrastructure, such as Arqiva.

The Investment Association therefore considers that communication towers and other mass telecom networks, such as optic fibre or mobile networks, could be considered as core infrastructure assets and included in EIOPA's analysis, in the same way that EIOPA has excluded airlines but included airports.

For this reason The Investment Association recommends that EIOPA consider Arqiva's bonds in its analysis – see below.

Issuer Name	ISIN	CUSIP
Arqiva	XS1251096753	UV391804 Corp
Arqiva	XS0895820834	EJ555729 Corp
Arqiva	XS1024447010	EK036481 Corp
Arqiva	XS0895821055	EJ555989 Corp
Arqiva	XS0894469880	EJ567281 Corp
Arqiva	XS0894470110	EJ565185 Corp

Question 3.

a) What is the volume of infrastructure corporates without an ECAI rating?

Investors would not normally expect to see a credit rating for a corporate with an issuance size of below £250m, and many infrastructure corporates are not large – for example most regional airports are unrated. However, it is not uncommon for corporates to decide against

	getting a rating even for issuance sizes of £300m to £400m, partly as a result of the costs associated with a rating but also because issuers may want to avoid the addition of a third party to the process. It is also not uncommon for some large corporates to issue both public and private unlisted debt. In such an instance, their unrated unlisted debt will nonetheless often be considered 'safer' than the rated listed debt of a smaller corporate. **b) What is the typical amount of a corporate debt issuance? How does this relate to the cost of obtaining an ECAI rating?** Aside from the initial cost of obtaining a rating (which can cost hundreds of thousands of pounds), there are significant ongoing fees. The initial cost tends not to vary across issuances of different sizes. However, ongoing fees will be based on a percentage of the issuance size, and as a result these fees will be larger for larger issuances. In addition, some corporates will seek multiple ratings. This will result in a multiplication of costs. **c) What criteria could be used to identify suitable debt without an ECAI rating and to eliminate unsuitable investments? Please provide specific proposals.** Investors typically consider the credit quality of an asset before assessing the capital structure. The credit profile (i.e. business risk) will highlight to investors whether or not an investment falls into the definition of "infrastructure". The capital structure will then, in part, drive the likely rating of the asset.	
Section 8.3.		
Section 8.4.		

Question 4.	**a) Do you have specific examples of infrastructure sectors and corporate structures that would inadvertently fall outside this definition?** The Investment Association notes that the currently proposed definition of 'infrastructure corporate' would exclude: • Infrastructure assets operating in OECD countries that are not in the EEA – the definition refers only to infrastructure assets in the EEA. This is despite the fact that EIOPA's portfolio analysis included entities which earned a meaningful part of their revenues from countries within the EEA *or* OECD. This definition would exclude, for example, Australian airports which issue sterling bonds. • Electricity and gas storage facilities – The definition refers only to generation, transmission or distribution of electricity and gas, and excludes storage facilities, which are an integral part of the network. • Waste management services – While recycling services are included, other forms of waste management are currently excluded. • Telecoms – As noted in the response to question 2, The Investment Association considers that telecoms infrastructure has a strong social benefit, and that it is often possible to separate regulated infrastructure activities from non-regulated consumer goods business. The Investment Association is also concerned that the requirement for unrated corporates to have a five-year track record is overly broad. As it currently stands it would exclude all new infrastructure corporates, even where there is some record of past performance. For example, the wording would exclude: • A waste management corporate moving into waste incineration; • Assets sold off by the government to form a new corporate.	•

The requirement could also exclude high-performing corporates or corporates with strong regulatory support who have only been operating for a short period of time, such as Arqiva or Thames Tideway.

The current definition would also risk discouraging innovation and investment in new technologies - there have been recent examples of solar generation debt issuance which does not have a rating and has less than five years of operational history.

With regards to the need for an ECAI rating, most ratings of infrastructure corporates will be senior secured ratings, while the definition currently only refers to an assessment for senior unsecured exposures. Where only a senior secured exposure issued by an ECAI for the infrastructure corporate exists, it should be used.

Finally, the requirement for an infrastructure corporate to derive "*the vast majority* of its revenues from owning, financing, developing or operating infrastructure assets" is potentially problematic as it is unclear what a "vast majority" would represent. This could be interpreted to mean that any infrastructure corporate with more than *de minimis* ancillary revenues could be excluded, which The Investment Association considers to be overly restrictive.

While The Investment Association understands from paragraph 1.166 that EIOPA is concerned that the use of the word 'predominantly', rather than 'the vast majority', could in theory allow investments to qualify that only conducted just over 50% infrastructure business, in the investment world this phrase is usually taken to indicate a figure in the region of 75-80%. The phrase "significant majority" could also be used as an alternative.

b) What volumes would such examples represent?

c) Regarding the requirement for a minimum number of years of operation or for an external credit assessment specifically, are there cases where would this lead to the

	exclusion of safer infrastructure corporates? If so, how would you propose to appropriately limit the construction or operating risks; would the requirements for infrastructure projects be appropriate for example? Infrastructure projects and corporates have different structures, and the criteria for projects will not necessarily be fully applicable to corporates. It is more difficult to limit construction and operating risk for infrastructure corporates when compared to infrastructure projects, in part because management has greater discretion and corporates are more likely have a larger range of alternative businesses. Nonetheless, in the regulated space capital expenditure is subject to regulatory approval, while business limitation covenants are used by investors to require a strict cap on non-infrastructure business, requiring a majority of income to come from regulated activities.	
Question 5.	**Are there other criteria not covered by this section (Section 8.4) that are used by investors to identify safer infrastructure corporates?**	
Section 9.1.		
Section 9.2.		
Question 6.	**Do you envisage any difficulties to distinguish between revenues stemming from infrastructure compared to non-infrastructure activities? Please justify your response.** For infrastructure corporates, this will be largely dependent on how ring-fencing of infrastructure activities has been set up. Investors will often require infrastructure corporates to have business limitation covenants in place, although a small amount of non-infrastructure revenue is usually accepted. For example, a covenant may require 85% of revenue to come from regulated activities. Infrastructure projects are not likely to have significant non-regulated business activities, although there may be circumstances in which investors will permit a *de minimis* portion of revenue to come from such activities. For example, a hospital may receive income from attached shops, or a school from an attached daycare.	
Question 7.	a) **Would option 1 (compared to option 2) lead to the exclusion of arrangements which**	

provide an equivalent level of protection to asset security and an equity pledge? Please provide specific reasons and examples.

There has been a lack of consensus amongst Investment Association members on this issue. Some investors are supportive of option 1, which they feel has the advantage of being simpler while at the same time providing adequate protection to investors. Investors with a preference for option 1 are also concerned that under option 2 there is a risk of different interpretations by different member state supervisory authorities.

However, other investors have noted that in many jurisdictions it cannot be assumed that direct pledge of equity would be granted as required under option 1. Rather a decision is required as to the level of security that is necessary, proportionate and beneficial. Accordingly, these investors consider that option 2 is preferable and consistent with market practice in many jurisdictions.

In addition these investors are concerned that the requirement for a comprehensive security package under option 1 could exclude infrastructure corporates without such a package but which would nonetheless normally be treated as 'safe' infrastructure investments as a result of additional regulatory protections.

Finally option 1 as currently worded requires debt providers to be "*able to take control of the operation of the infrastructure project <u>prior to default</u>.*" Investors have noted that it is not possible to step in prior to a default occurring, as to do so could compromise their ability to enforce their security.

The Investment Association considers that decisions on contractual terms should largely be left to the investor and the corporate, with minimal regulatory involvement.

	b) Do you consider that a "negative pledge" clause can provides equivalent protection to the security arrangements required by the proposals in Section 9.3? No. While a negative pledge clause may be a covenant that investors wish to include in the contractual terms, it should be combined with some sort of controlling rights, privileged access to the underlying assets or cash flows, or contracts, depending on the nature of the underlying infrastructure activity. **c) If yes, please provide specific reasons and examples of infrastructure sectors and countries where a "negative pledge" should be allowed without compromising the safety and recovery of your investment.**	
Section 9.3.		
Section 10.1.		
Question 8.	**a) In view of the proposed change to the scope of the infrastructure project asset class, do you agree that the risk management requirements remain appropriate? Yes, the WG believes that that same risk management requirements are appropriate for infrastructure SPVs and corporates.** The risk management requirements for infrastructure projects remain appropriate. **b) In particular, will the information required to comply with the risk management requirements for infrastructure projects be available to insurers?** **c) If not, how would an insurer satisfy itself regarding the safety of the investment, without an excessive or mechanistic reliance upon external ratings?**	
Section 10.2.		
Annex I		
Annex I Questions	**a) Do you agree with the assessment of benefits? Are there other benefits that have not been identified?**	

	b) Do you agree with the assessment of costs? Are there other costs that have not been identified? **c) Regarding policy issue 1, what would be the volume of qualifying infrastructure investments under the different policy options?**	
Annex III		
Annex IV		
Annex V		