EIOPA work on infrastructure

IRSG meeting
Frankfurt, 10 June 2015

Proposals for Criteria (1)

- Purpose:
  - Ensure sufficient quality of equities and unrated debt
  - Make sure that eligible infrastructure is sufficiently similar to the infrastructure that was used for calibration

- Sources:
  - Basel II
  - Criteria used by rating agencies
  - Properties of well-performing infrastructure investments

Proposals for Criteria (2)

- Relatively broad definition of infrastructure
- Focus on infrastructure **projects**

- Key criteria
  - o Stable cash flows
  - o Robust under a number of stresses
  - o Robust contractual framework
  - o Low financial risk
  - o Construction risk properly mitigated
- Different criteria for rated debt, unrated debt and equity

Pillar II Requirements: Proposals

- Proper review of all criteria validated by independent expert
- Mechanisms to ensure active engagement for material holdings
  - Proposal: Contingency plans in case of distress and access to relevant expertise
- Mechanisms to ensure hold-to-maturity if assumed in the calibration
  - Proposal: Solvency and liquidity position and strategies, processes and reporting procedures for asset–liability management ensure ability to hold to maturity with level of confidence consistent with Article 101 (3) Solvency II.

Calibration of Debt in the SF: Proposals (1)

- Calibration for unrated debt based on calibration for rated debt assuming certain credit quality
- Idea 1: Modify existing spread risk charge to take potentially into account:
  - o Ability to hold to maturity
  - o Different credit risk
- Steps:
  - o Decomposition into a) credit risk and b) liquidity component
  - o Reduce component a) and/or b)

Pros and Cons idea 1

The following applies to a) and/or b)

Pros:

- Risk of deterioration in credit quality captured
- Risk measurement based on market price for risk
- Consistency with SII valuation
- Consistency with current treatment of other debt

Cons:

- Ambiguity regarding split
- Use of evidence on default and recovery rates
- Safeguards to ensure hold-to-maturity sufficient?

Calibration of Debt in the SF: Proposals (2)

- Idea 2: Base calibration on variation of initial spreads for infrastructure projects
- Pros and cons:
  - Best information on market price of infrastructure project debt available (+)
  - Information only for the start of the project (-)
  - Availability of information on credit quality (-)

Calibration of Debt in the SF: Counterparty default risk module

Advantages:

- Evidence on default and recovery rates directly useable

Disadvantages:

- Mismatch with valuation
- Risk of deterioration in credit quality short of default not captured
- Safeguards to ensure hold-to-maturity sufficient?

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Thank you