EIOPA-15/821
19 Nov 2015

# Call for evidence concerning the request to EIOPA for further technical advice on the identification and calibration of other infrastructure investment risk categories i.e. infrastructure corporates

## Responding to this paper

EIOPA welcomes responses to the Call for evidence concerning the request to EIOPA for further technical advice on the identification and calibration of other infrastructure investment risk categories i.e. infrastructure corporates.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email **CP-15-009@eiopa.europa.eu**, by 10 December 2015.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

### Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents[1].

Contributions will be made available at the end of the public consultation period.

### Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied.

EIOPA, as a European Authority, will process any personal data in line with Regulation (EC) No 45/2001 on the protection of the individuals with regards to the processing of personal data by the Community institutions and bodies and on the free movement of such data. More information on data protection can be found at https://eiopa.europa.eu/ under the heading 'Legal notice'.

[1] Public Access to Documents

## Reasons for publication

On the 21 October 2015, the European Commission issued a call for advice[2] to EIOPA for further technical advice on the identification and calibration of infrastructure investment risk categories in Commission Delegated Regulation (EU) 2015/35 on Solvency II (hereinafter "Delegated Regulation").[3]

This request follows a previous call for advice on the topic of infrastructure, the response to which was submitted to the European Commission on 29 September 2015 (hereinafter "first call for advice"). In that response, EIOPA proposed a more granular treatment of debt and equity investments in qualifying infrastructure projects.[4]

With the latest call for advice from the Commission, EIOPA has been asked to further consider the evidence regarding the treatment of "infrastructure corporates". As a first step in responding to this call for advice, EIOPA would like to launch a call for evidence to try to gather further information and data on the nature of infrastructure corporates and their risk profile.

### Structure of this paper

This paper describes the evidence that EIOPA is aware of based on the previous call for advice on infrastructure and sets out the specific areas where EIOPA would be interested to know if additional evidence or data is available.

### Next Steps

Based on the feedback received, EIOPA will prepare draft advice to the European Commission. Depending on the nature of those proposals EIOPA may issue a consultation paper in the first half of 2016.

[2] Call for advice on infrastructure corporates
[3] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0035&from=EN. On September 30 the European Commission suggested amendments covering also the treatment of infrastructure investments (http://ec.europa.eu/finance/insurance/docs/solvency/solvency2/amendment/20150930-amendment-to-the-delegated-act_en.pdf).
[4] Infrastructure final advice September 2015

# 1. Existing evidence and analysis regarding infrastructure corporates

EIOPA analysed the different types of infrastructure financing during the first call for advice, including via corporate entities. EIOPA's aim was to identify a category of infrastructure investments for which a different treatment[5] within the SCR standard formula could be prudentially justified based on the evidence. During the course of the analysis, EIOPA identified convincing evidence to support a different treatment for infrastructure investments via project finance structures. EIOPA was also aware of some evidence relating to corporate financing and various stakeholders argued that such corporates have lower volatility and higher recovery rates compared to corporate bonds in general, as well that a similar level of protection to investors in project finance structures could be provided, for example via the use of covenants.[6]

However, EIOPA had a number of reservations regarding infrastructure corporates. In response to CP 15/004 on the draft advice, EIOPA stated that:

> *EIOPA has considered the comments received and would acknowledge that there is some evidence that "infrastructure corporates" have performed better than other types of corporates. However, the evidence is much less convincing than for infrastructure projects. In addition, as stated in the consultation paper, there are delineation problems regarding the ability of corporates to enter into other business activities besides infrastructure. EIOPA does not consider that the proposals received from stakeholders adequately address this challenge.*
>
> *Therefore, bearing in mind EIOPA's deadline for delivering its advice to the European Commission, EIOPA has decided to not advise for the inclusion of "infrastructure corporates" within the scope of qualifying infrastructure. Nevertheless, EIOPA expects to consider this issue further in the medium-term as part of its monitoring of the appropriateness of the SCR standard formula.*

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[5] Prior to EIOPA's advice, the Solvency II standard formula did not contain a specific treatment or module for infrastructure investments and therefore such investments would normally have been treated as an equity investment, or as a corporate bond or loan.

[6] With respect to the evidence see Annex I in https://eiopa.europa.eu/Publications/Consultations/Consultation%20Paper%20Call%20for%20Advice%20Infrastructure.pdf

## 2. Identification of infrastructure corporates and potential qualifying criteria

During this second call for advice EIOPA considers that it is appropriate to investigate further the evidence available regarding infrastructure corporates and as well the definition of such an investment risk category, i.e. the delineation issues. For this purpose, EIOPA would welcome further input from industry practitioners and other interested parties. The questions set out below describe the areas where EIOPA would welcome further information.

**Identification of infrastructure corporates and qualifying criteria**

Q1: What are the reasons for choosing a corporate instead of a project structure for infrastructure investments? Are there certain sectors for which a corporate structure is more prevalent and, if so, why is this the case?

Q2: What types of infrastructure corporates do you think have a more favourable risk profile than implied by their standard formula treatment?

Q3: With respect to the types of infrastructure corporates you listed in the previous question, please answer the following:

a. What kind of infrastructure services is provided?
b. Where is the infrastructure located?
c. What is the legal form?
d. Does the debt have a rating by an External Credit Assessment Institution?
e. What is the volume of the debt and equity instruments currently outstanding? How will these quantities evolve in the future? Why?
f. What is the volume of investments by insurers? How will this evolve in the future? Why?
g. Are there any other relevant properties?

Q4: Are there definitions of infrastructure corporates in existing legislation or other sources that could be used?

Q5: Which criteria from the EIOPA advice in response to the first call for advice, or from the amendments to the delegated regulation adopted by the European Commission would the infrastructure corporates you suggested not satisfy?

Q6: Do you think that the criteria referred to in the previous question could be modified so that a similar outcome is achieved from a risk perspective but the infrastructure corporates you suggested would qualify? Areas of particular interest would be:

a. Predictability of cash flows

b. The privileged access of investors to cash flows or assets

c. The use of covenants

d. Restrictions on the ownership of assets

e. The use of Licensing or permitting restrictions

f. The ability of the entity to withstand relevant stress scenarios

g. Refinancing risk

Q7: For questions 5 and 6, is it relevant to make a distinction between new, compared to existing, debt and equity issued by infrastructure corporates?

Q8: Infrastructure corporates may engage in activities not or only indirectly related to the provision of infrastructure services. What would be appropriate criteria to ensure that such activities are of only limited importance or not material in relation to the payments to investors?

Q9: Infrastructure corporates may comprise the construction or operation of different infrastructure assets with different risk profiles. In case a "look-through" approach was applied for the identification of eligible infrastructure corporates (i.e. the properties of the underlying infrastructure assets are taken into account): What could be suitable criteria for allowing a corporate entity with some higher risk assets to be eligible provided such assets or activities are not material?

Q10: In their responses to CP 15/004 some stakeholders proposed that the assets pertaining to infrastructure activities could be effectively ring-fenced[7]. Are you able to provide further detail on such arrangements and their legal nature?

[7] For example see comments no. 2 and 13 within Annex 4 of EIOPA Final Report on Consultation Paper no. 15/004.

Q11: In their responses to the CP 15/004 some stakeholders proposed that very strong internal risk assessment and modelling capacities[8] were necessary to distinguish between infrastructure corporates and conventional corporates; what are the components of such capacities?

**Empirical evidence regarding infrastructure corporates**

Q12: What is the empirical evidence that the infrastructure corporates you identified have a lower risk profile than suggested by their current standard formula treatment?

Q13: Regarding the Moody's study on default and recovery rates for infrastructure corporates[9], do you think this data represents a suitable proxy for the infrastructure investments you have identified, and if so, why?

Q14: Do you think that the calibration EIOPA proposed in response to the first call for advice could be used for the infrastructure corporates you suggested? If so, please provide quantitative or qualitative evidence that the criteria you proposed would result in a similar risk profile to the eligible infrastructure investments in the EIOPA advice?

Q15: What is the empirical evidence for the infrastructure corporates you identified with respect to adequate correlation parameters? Can you suggest a concrete approach to derive these parameters from the data?

Q16: Where you have referred to evidence in the form of cash flows in your previous answers, can you please provide the following:

a. a concrete proposal for how this evidence could be translated into a calibration
b. explain how EIOPA could access this evidence

Q17: Can you provide data on spreads for bonds issued by infrastructure corporates? Are there any indices for bonds of infrastructure corporates?

[8] For example see comment no. 56 and similar remarks in comments nos. 57 and 58 within Annex 4 of EIOPA Final Report on Consultation Paper no. 15/004.
[9] Moody's Investors Service: Infrastructure Default and Recovery Rates, 1983-2014, March 2015