	Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation	Deadline 5 January 2018 23:59 CET
Name of Company:	Bundesverband Alternative Investments e.V.	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-17-006@eiopa.europa.eu** **Our IT tool does not allow processing of any other formats.** **The numbering of the reference refers to the sections** of the consultation paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation. Please indicate to which paragraph(s) your comment refers to.	
Reference	**Comment**	
General Comment		
Introduction		
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10.1	We recommend <u>not to limit</u> the scope to the Credit Quality Step (CQS) 2. For example, the current requirements for qualifying infrastructure (corporates) distinguishes between CQS 1-3 and the qualifying criteria are mapped to the CQS 3 since an unrated qualifying loan would be treated in the same way as a CQS 3 rated qualifying loan. It should be also noted that the segments of private debt that are attractive for Solvency II investors usually have a CQS 3 or 4. This is because a certain minimum return is necessary in order to outweigh the costs of the additional complexity and processes. Therefore, assets fulfilling CQS 2 criteria might not be of interest for private debt processes of Solvency II investors. A further argument against one set of criteria for all asset classes is that there might be no clearly identifiable and meaningful ratios applicable to different asset classes in the same way. For example, return on sales (margin or EBITDA / Sales) might be a two digit number (e.g. 15%) in one industry and a low on digit number (e.g. 3%) in another industry and they could be still below or above the industry average. An internal rating process based on market standards wouldn't have that disadvantage as it could flexibly adjust the criteria based on the individual requirements of the asset class / the asset. Instead of limiting the scope to CQS 2, Solvency II investors should implement internal rating	

	processes and if those processes are of similar quality as external ratings, Solvency II investors should be able to use those ratings in the calculation of SCR.	
10.2		
10.3	We support the suggestion that internal ratings should be allowed to be used for the calculation of SCR subject to the requirement that the investor can demonstrate that it implemented an internal rating process based on the industry standards for ratings such as Basel II and / or ECAI regulations. Alternatively and / or additionally, Solvency II internal ratings provided by other regulated institutions should be used subject to the condition that those ratings are regulated according to the industry standards such Basel II or ECAI regulations. Such institutions are usually: • Other Solvency II regulated insurance companies co-investing into an asset • Banks • AIFMs in certain jurisdiction such as Germany and Ireland where the internal rating requirements for AIFMs is similar to the process applied by banks	
10.4.1		
10.4.2.1	See our comment on 10.1	
10.4.2.2		
10.4.2.3	See our comment on 10.3 The definition of additional criteria could be avoided if Solvency II investors could demonstrate that (1) the rating process was performed based on the market standards and (2) the outcome of the process was CQS 2 provided that the scope is still limited to CQS 2.	
10.4.2.4	See our comment in 10.3. AIFMs should be also considered as they may apply the same tools and be regulated by similar rules (e.g. Germany).	
10.4.2.5		

| 10.4.3 | | |
| 11.1 | First of all, we would like to emphasize again (c.f. our comments regarding CP-17–003 as of May 24, 2017) that a mandate which simply aims to shift such portfolios or assets from the type 2 equities category to the type 1 category is neither reflecting the **factual risk-return-profile of those assets** (c.f. (b) below) nor does it result into an **enhanced treatment of most of these assets compared to the status quo** (c.f. (a) below:

(a) Art. 168 para 6 delegated regulation 2015/35 already provides that

(i) VC funds under the EuVECA regulation (section b) but also
(ii) closed-ended and unleveraged AIFs which are established in the Union or equities held by them (section c)

shall be considered as type 1 equities. In other words: a large majority of AIFs/unlisted equities (especially the segment private equity) is covered anyway by the above mentioned provision (Art. 168 para 6 delegated regulation 2015/35), subject to the national interpretation of the definition of leverage. Therefore the scope and the target of this consultation process might lag significantly behind the goals of the CMU (i.a. the investment plan for Europe supporting the financing of start-ups, SMEs and non-lilsted companies, etc. on the one hand and supporting the EU insurance sector with regard to a risk-based, sustainable asset allocation, especially but not exclusively in the low interest rate environment on the other hand). In consequence the question has to be raised which goals can be achieved by this part of the Solvency review? For the moment it appears that there will be only an alternative route to reach the status quo.

(b) Besides the fact, that a broad range of porfolios/assets is already included in the type 1 equities category, even more striking is the fact that a treatment in this category still **does not really reflect their risk-return-profiles which might justify equity risk charges below the ones for the type 1 equities category**. We provided evidence for this in our comments regarding CP-17-003 and therefore simply refer to our earlier feedback paper. Of course we acknowledge that | |

	EIOPA assessed our comments (c.f. i.a. no. 764, 774, etc. of the CP), however, we believe it would be beneficial to reassess these comments at this stage of the consultation process based on the robust scientific standards we referred to. We also still believe that a mandate which is limited to portfolios of equity from the EEA is too narrow as the PE market is not only a global market but also dominated by US transactions and funds. Therefore and especially for diversification purposes it should be **mandatory to include portfolios from OECD countries.** In this context we would like to highlight that such an approach is also consistent with the general Solvency II provisions such as type 1 equities (EEA & OECD) as well as qualifying infrastructure (corporate) investments (EEA & OECD)! We understand that this is one aspect the Commission has to take into account as well, nevertheless it has to be addresses in this stage of the consultation, too, especially as we believe that the extension of the scope to OECD countries will also have a positive impact on investments into EEA portfolios as the businesses between OECD and EEA are usually strongly interconnected. Just for the sake of completeness we therefore would like to reaffirm that we still believe that an alternative approach by introducing a new equity risk sub-module for so-called "Qualifying Private Equity Fund Investments" (Qualifying PE) to the standard formula of Solvency II, which goes beyond the idea/approach outlined by the Commission and taken over by EIOPA in the consultation paper which is simply linked to type 1 equities, would be an appropriate way to reflect the risk-return-profile of unlisted equity in the SCR.	
11.2	Regarding the legal basis we would like to refer again to art. 168 para 6 delegated regulation 2015/35 and the treatment as type 1 equity already given.	
11.3	We support the EIOPA statement in no. 771. to apply the look-through approach to sufficiently diversified portfolios. This is one of the main assumptions of our "qualifiying PE" approach we suggested.	
11.4.1		
11.4.2	We strongly support EIOPA's indication in no. 789 to further take into account risk management	

process of the insurer as this reflects the general idea of the prudent person principle.

Regarding the statement in no. 790 that "unlisted equities should not benefit form the absence of market prices" we would like to clarify that e.g. AIF(M)s subject to AIFMD have to undertake an independent valuation, either mandating third parties or being validated by auditors, etc. EIOPA should bear these facts in mind and not acknowledge these valuations (c.f. also no. 865 where EIOPA itself requires an independent valuation, which is of course in line with AIFMD).

With regard to the beta method in no. 793 et seq. and the stressed period loss method in no. 818 et seq. we would like to emphasize again, that we strongly believe that there is indeed sufficient data for private equity funds (and transactions/portfolio companies) as, for example, presented by Cepres. The VaR 99.5% can be determined according to robust scientific standards and applied to the new qualifying asset class. This approach would be consistent with the majority of the calibrations used by EIOPA for other risk modules (e.g. type 1 equities, spread, FX). The now suggested approaches (beta method and stressed period loss method) add additional complexity without improving the quality compared to other, more simple methods. The methodology suggested by EIOPA concludes into a hypothetical beta and the sector shocks are calibrated on the basis of data for liquid markets.

Furthermore, regarding the criteria and considerations laid down in no. 858 to 870, we would like to make the following comments:

Regarding no. 860 we would like to highlight that there has to be a distinction between leverage on fund level and leverage on portfolio company level. Indeed there is hardly or no leverage on fund level, maybe only short-term for internal financing purposes. This matter is anyway adequately addressed within AIFMD. Furthermore it remains unclear if EIOPA tries to make a link between leverage and look-through in no. 860. Both aspects have to be treated separately.

Regarding no. 861 we would refer to our initional comments and our parameter laid down regarding a so-called "private equity investment program" the insurer shall pursue and which

	shall safeguard a long-term approach with constant commitments year by year. This assumption is realistic and can be observed in the market and which should lead to an average maturity of the portfolio that is balanced at a 5-8 years funds' lifetime (based on a 12-24 years final lifetime of the funds). Regarding no. 863 we would like to point out that it is more or less unrealistic to request smaller or medium-sized insures to have a portfolio of at least 25 independent fund managers. Even a fund-of-funds does not always diversify among 25 independent managers. In our initial comments we already suggested a well-diversified portfolio with respect to geography, stock size, investment and financing styles as well as vintage years. At the same time we suggested in our earlier comments that within the AIF not more than 30% of the NAV should be allocated to one investment, the AIF portfolio should contain – in average – 6-8 investments ; furthermore the use of derivatives within the AIF should be limited to risk mitigation Furthermore we agree to the statements and requiremtens in no. 868 to 870.	
11.4.3	We basically refer again to our comments above regarding section 11. In detail we strongly disagree with the EU/EEA limitation and the diversification requirement of at least 25 fund managers, which absolutely does not reflect typical diversification parameter of (single) funds. We also do not understand that the diversification delivered by the funds itself is not appropriately reflected in this approach suggested by EIOPA. Further comments of the various criteria laid down in no. 882. **Underlying investments** The criterion "common equity" should be also extended to equity-like structures, especially including mezzanine. Those financial instruments would usually not qualify for the debt modules (spread, interest rate) and have a more conservative risk profile than common equity. For this reason such financing structures should also benefit from the SCR reduction.	

The criterion "majority of company staff located in EU / EEA" doesn't seem to reflect the nature of the globalised environment. Besides, it might be difficult to obtain that data in practice as well as to define what a "majority" is (50.01%?). This criterion should be removed and the only focus should be on the revenues.

The criterion "established in the EEA" should be removed as well. For example, a company established outside of the EEA but having the majority of the revenues in the EEA should be eligible since it is in line with the goals of the CMU. The only focus should be on the revenues.

Vehicle
The term "moderate leverage" could be defined in line with the Art. 111 (1) of the Delegated Regulation (EU) No 231/2013 where significant leverage is defined as exceeding 3 times the NAV.

Diversification
First of all, it is unclear why the diversification requirement is based on managers and not on investments in the portfolio which expose the investor to the market risk. Instead of setting the requirement on the managers, it might make more sense and be more consistent to the processes in practice to require a long-term ongoing investment strategy, e.g. documented in the Strategic Asset Allocation.

If managers (being a mediator variable rather than a direct market risk driver) are subject to the diversification requirements, it is unclear why the requirement is so high. A typical fund of fund structure where the fund of fund manager is constructing a private equity fund portfolio for the investor has 10 – 15 target funds / fund managers which is usually considered to be sufficiently diversified in practice. The requirement of 25 managers could create overdiversification and lead to a **dramatical increase of expenses and administrative burdens.** It would force a lot of insurers to increase the number of managers significantly which requires extensive due diligence and manager selection efforts.

Further remark

	In our view the scope of the "qualifying PE" should be exclusively limited to portfolios. A single private equity investment can have a very high volatility / high VaR which can be only reduced through a diversified strategy. Funds (e.g. AIF) can be a very practical way to clearly define a portfolio. This is why we suggest to exclusively create a category "qualifying PE fund" or "qualifying PE portfolio". The advantage would be that the portfolio / the strategy could benefit from the SCR reduction as a whole. The reporting and risk management according to the look-through principle should be unaffected by this provision, since the calculation of the SCR, reporting and Pillar 2 risk management are different processes. **Calibration of the SCR equity stress** It is unclear why EIOPA uses such complicated theoretical methods for the calibration if there is sufficient data for private equity funds as, for example, presented by Cepres. The VaR 99.5% can be determined according to robust scientific standards and applied to the new qualifying asset class. This approach would be consistent with the majority of the calibrations used by EIOPA for other risk modules (e.g. type 1 equities, spread, FX). In our view the suggested approaches add additional complexity without improving the quality compared to other, more simple methods.	
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