Response to the Consultation Paper No. CP-16-005 on the request to EIOPA for further technical advice on the identification and calibration of other infrastructure investment risk categories i.e. infrastructure corporates

Invest Europe welcomes the opportunity to respond to EIOPA’s consultation paper on infrastructure corporates and appreciates that EIOPA is seeking further feedback on the proposed approach before specifying its final advice to the European Commission.

Question 1: unlisted assets
(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?
(b) If not, please provide a comprehensive justification and supporting evidence, including data, International Securities Identification Numbers (ISIN) codes and examples.

Although it may be an appropriate proxy for listed infrastructure corporates, we remain of the view that the risk weighting for unlisted infrastructure corporates should not be derived from an index or list of listed entities. This is a horizontal issue that investors in other unlisted, long-term, illiquid asset classes face within Solvency II. Not only does such an approach fail to reflect the real risk that investors face when investing in such assets it measures a risk which does not really exist for investors in these assets.

We note that EIOPA has stated that “in principle the (short-term) risk of an entity should not depend on whether it is listed or not” but we disagree with this view. While listed and unlisted infrastructure assets might share certain characteristics (based for example on the sector or the nature of asset) the very fact that one is in private ownership and the other is traded on a public market has a profound impact on the riskiness of that asset from the perspective of an investor.

In the short-term the existence of a market price for an asset, determined in a market that is both liquid and deep, has a profound impact on the investor’s risk when investing in the asset. If an asset does not have a daily market price then market price volatility is not a relevant measure of the risk faced by investors investing in that particular asset (even if other assets that share certain characteristics do have such a price).

There are also reasons why listed and unlisted (infrastructure) corporates would have different risk profiles. For example, listed infrastructure corporates might be more volatile than their unlisted equivalents because they are exposed to additional factors such as general market volatility, which is driven by short-term market sentiment, that are unrelated to the underlying characteristics, condition or performance of the assets.
Given the diverse nature of infrastructure investing the sectors and sub-sectors in which listed and unlisted infrastructure corporates operate may differ substantially, leading to differences in performance and volatility.

We believe that there are other options that could be used to calibrate a risk charge for unlisted infrastructure corporates. A possible solution could be to use the net asset value (NAV) of such corporates to determine the volatility of such assets. One could also consider analysing the cash flow volatility of unlisted infrastructure corporates or volatility in EBITDA. These alternatives would be much closer to market practice by investors and better reflect the true risk that insurers face when investing in those types of assets.

A mechanism could be found for insurance undertakings and / or infrastructure funds to provide EIOPA with access to an appropriate and representative sample of such data from which the volatility of unlisted infrastructure corporates could be derived with more accuracy.

Invest Europe’s infrastructure members, both fund managers and investors in those funds, would welcome the opportunity to discuss in greater detail with EIOPA how investors are currently measuring the risks of investing in unlisted infrastructure corporates and how an alternative data set of unlisted infrastructure corporates could be constructed, and then used to develop an appropriate risk calibration for this type of investment.

We recognise that EIOPA needs to make progress in order to meet the Commission’s deadline for advice and while in that context listed corporates might be seen as the most attractive and suitable approach we still have serious concerns whether it is the right proxy for unlisted infrastructure corporates.

However, even if such approach were taken then the portfolio of entities set out in Annex III of the consultation paper would need to be carefully constructed to provide the best possible (albeit sub-optimal) data set. In our view only pure infrastructure corporates whose primary business is the ownership and operation of (rather than service of) infrastructure assets should be used. In addition, the mix of subsectors represented would need to reflect those invested in by unlisted infrastructure corporates.

The list of selected entities should be looked at again in order to ensure that it captures only pure infrastructure corporates as currently it seems to capture companies that might not meet this criterion and are likely to bring additional volatility in to the index (i.e. ALPIQ, BKW, RWE and EDF).

**Question 2: telecoms**

(a) Do you agree with the assessment of the risks of telecom investments as evidenced by the historical price data?

(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 there may be reasons to believe that certain telecoms should be excluded from the definition of ‘infrastructure corporates’ we think that there are telecom investments that should be included in EIOPA’s consideration and able to benefit from a lower risk weight.

Telecommunication is an established infrastructure sector and is suitable for incorporation in the scope of the proposed definition of infrastructure corporates. The wholesale exclusion of all telecom investments is overly restrictive and has not been justified.

We believe that this blanket exclusion should be reconsidered and that EIOPA should allow investment into appropriate telecom infrastructure, particularly those whose business focuses on the provision of infrastructure as opposed to the provision of content (i.e. TV channels, data services, mobile plans, etc.), to fall under the definition of ‘infrastructure corporates’.

Telecom tower companies could be one example of telecom infrastructure suitable for the inclusion. Publicly traded telecom towers such as American Tower, Crown Castle, SBA Communications, Cellnex, Inwit, and El Towers should be able to provide EIOPA with sufficient evidence to justify overturning a wholesale exclusion of telecoms. Their business model is generally quite close to the profile of telecom infrastructure corporates.

Question 4: definition of infrastructure corporate
(a) Do you have specific examples of infrastructure sectors and corporate structures that would inadvertently fall outside this definition?
(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?

Question 5: other criteria for infrastructure corporates
Are there other criteria not covered by this section (Section 8.4) that are used by investors to identify safer infrastructure corporates?

The definition of ‘infrastructure corporate’ should be sufficiently broad to capture a wide range of corporate entities but at the same time it should concentrate on entities whose primary business is the ownership and operation of infrastructure assets. In principle it should not capture infrastructure corporates that are simply ‘service providers’ and have a high commodity element built into their business.
We think however that the new definition and certain criteria proposed in the consultation paper are overly restrictive and might exclude infrastructure corporates that we believe represent suitable infrastructure businesses to qualify as ‘infrastructure corporates’.

For example the list of activities provided in the definition is too narrow and might fail to capture some (important) parts of the infrastructure universe (see also our response to Question 2). In our opinion the list should only act as a guiding principle and not as a definitive list of sectors/activities that can qualify as infrastructure corporates.

The five-year test, which is required in the absence of an ECAI rating, might also be problematic as it excludes new enterprises, also those of already existing infrastructure businesses. For example some infrastructure funds carve out infrastructure assets from larger organisations that they have invested in and put them in a standalone entity or build a platform, which then they grow over time. While those entities have all the characteristics of infrastructure corporates they would fall outside of the definition if they don’t have a relevant rating. We do not believe this is justified and maintain that that proposed definition should provide some degree of flexibility to also capture such cases.

Also the proposed requirement for infrastructure corporate assets to be located in EEA countries is too restrictive and we do not consider it justified.

Although we appreciate EIOPA’s explanation and its reference to the policy objective of the CMU action plan to promote investments in Europe, such an approach would discriminate against infrastructure corporates which have substantially the same characteristics, are of equivalent quality, but are simply not located in EEA countries. In our view the mere fact that assets are not located in the EEA should not determine whether they can fall within the definition of infrastructure corporate or not. Such inclusion should be based on other, objective qualifying criteria.

We therefore encourage EIOPA to follow the same approach that is already foreseen for infrastructure projects and for type 1 equities under the current Solvency II rules and to extend the geographical scope of the definition of infrastructure corporate to assets located in OECD countries. If this clear precedent is not to be followed then EIOPA needs to give a clear explanation of the justifications for such discriminatory treatment and for the narrower geographic scope for this set of assets.

Moreover, we would like to reiterate that all infrastructure assets (both corporates and projects) that are subject to a robust, long-term and stable (EU or national) regulatory framework such as renewable energy projects that are backed by a state’s overall emissions reduction targets, should by definition qualify as ‘infrastructure’ under the Solvency II delegated act. We are concerned however that the consultation paper (but equally the current text of the Commission Delegated Regulation) does not provide enough clarity around this issue and we fear that such renewable assets could be left outside the scope of the proposed definitions, which we think should not be the case. To
this end, we would welcome clarification on whether such assets could meet the
definition and criteria currently proposed for both infrastructure projects and
corporates.

At the same time we appreciate EIOPA’s amendments to the definition of ‘infrastructure
projects’ and to the relevant qualifying criteria that intend to capture certain type of
infrastructure corporates.

**Question 8: risk management**

(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?
(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?

We think that some elements of the risk management system such as the validation
process of financial models and cash flow stress testing raise some practical questions
given that it is not clear how this process will work in practice. For example the text
does not provide sufficient clarity on whether an independent assessment would need to
be commissioned by insurance companies to validate their internal financial models or
by infrastructure fund managers who then report to their insurance investors. In our
opinion the former should be the case and the validation process should not lead to a
situation where a third party entity must start to review the financial models of
infrastructure funds/infrastructure corporates in which insurers have invested. This
would not be justified and too burdensome.

In general we believe that insurers will have sufficient information to assess their
infrastructure investments. Nonetheless we believe that it is important to ensure that
there is a workable reporting framework in place that would facilitate exchange of
necessary data/information between insurers and their relevant counterparts but at the
same time could be implemented with due consideration of costs and benefits.

Typically, all investors (or ‘limited partners’ in the language used by private equity and
infrastructure funds) that have equity stakes in infrastructure funds receive, on a regular
basis (i.e. quarterly), information providing details about funds’ underlying assets and
their on-going performance.

The European fund industry has developed reporting guidelines that are designed to
provide ‘best practice’ advice to fund managers on how to report to their investors. These Guidelines - produced by the Invest Europe Professional Standards Committee - are widely used across the industry and are reviewed and updated regularly to ensure that they remain appropriate and to take account of changing circumstances, including the changing needs of investors.
As Invest Europe’s membership includes fund managers (‘GPs’) and investors (‘LPs’) these Guidelines benefit from detailed input from both constituencies, both from those GPs and LPs on the Professional Standards Committee and from consultation of the wider membership. In October 2015 Invest Europe published a revised version of its Investor Reporting Guidelines.

Before investors make the decision to invest in an infrastructure fund, they conduct detailed due diligence on the investment manager and investment strategy to be pursued. This will, among other things, include receiving information about the fund’s strategy and its investment parameters (e.g. how much of the fund’s assets will be invested in OECD countries, how much outside OECD, how much will be invested in core/non-core infrastructure activities, etc.) and checking and analysing the fund manager’s previous track record. Detailed information about the actual investments made by the fund and regular information about how the investments are performing only become available once the fund starts investing. Investors will also follow their own internal procedures for monitoring and managing their portfolio of infrastructure funds, which will include assessing the risks of portfolio and the place of these investments in the investor’s overall investment strategy.
About Invest Europe

Invest Europe is the association representing Europe’s private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe’s leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members’ role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry’s professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.

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