Association of British Insurers

ABI RESPONSE: EIOPA CONSULTATION ON IDENTIFICATION AND CALIBRATION OF INFRASTRUCTURE CORPORATES

16 May 2016

General comments

The ABI appreciates the opportunity to contribute to EIOPA's work on the identification and calibration of infrastructure corporates. We have called for the inclusion of corporates within the definition of the infrastructure investment asset class during the original consultation, and have subsequently welcomed the European Commission's further call of advice.

The ABI very much supports the inclusion of qualifying infrastructure corporates within the infrastructure asset class under Solvency II. The proposals are a positive step in the right direction, although there are areas where further improvements would be desirable – the main aspect being that we support the extension of the capital treatment offered to infrastructure projects to corporates.

The ABI is broadly supportive of the proposals for the identification of infrastructure corporates. We are also pleased to see the proposed modification to the scope of project finance which would capture certain cases where infrastructure is funded in ways other than through an SPV structure.

Calibration of infrastructure corporates

As mentioned above, our key concern remains the difference in treatment between infrastructure project finance and infrastructure corporates. We believe that the driving force behind calibrations should be the underlying risk profile of assets, rather than the choice of operating structure. We therefore continue to support the extension of the capital treatment for infrastructure to all such undertakings, be they structured as project finance or qualifying corporates.

We recognise that while many infrastructure corporates have a better risk profile than traditional debt instruments, not all do. We are not focused on seeking to make the universe of infrastructure as wide as possible (which would have the effect of including some corporates where the benefit to risk profile is marginal and hence the level of capital benefit correspondingly low); rather, we are focused on EIOPA adopting a more correct and narrow field where a greater benefit may be given, in line with that for infrastructure projects. It is therefore likely to focus on those businesses where investors have security / financial covenants, or where these effects are replicated by regulation.

We strongly believe that regulatory treatment should be based on substance, rather than form, to prevent distortions. A project can often be established either as a corporate or a project entity - this decision is based on a range of commercial considerations, and the regulatory framework should avoid incentivising one over another. As an illustration, it would not make sense for an entity to face a cliff effect of capital changes merely because a project entity gets incorporated (or vice versa). We therefore strongly believe that projects with the same characteristics and risk profiles should be treated in the same way, irrespective of whether one is structured as project finance and the other as a corporate.

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We note that the capital charges for infrastructure are already conservative compared to the underlying economic risks for insurers, which are the risk of default for bonds and the risk of long-term underperformance for equity. The addition of the qualifying criteria should give further assurance that the investments captured should have an even better risk profile than the total population of infrastructure investments.

The data previously supplied from two separate Moody's reports highlights average recovery for project finance debt of 80%, and for senior secured infrastructure debt of 75%, versus [53%] for senior secured corporates and [37%] for senior unsecured corporates. This is acknowledged by EIOPA in para 1.110 in Section 7.4.

Finally, to ensure a consistent approach, it would be helpful to reflect the analysis in the derivation of the Fundamental Spread within the Matching Adjustment calculation. This could readily be done either by changing the default and downgrade rates, or more holistically through an increase in the recovery rate.

Section 1.3.

We believe that a single infrastructure investment class capturing both project finance and corporates would be a clearer and more straightforward approach than creating two separate infrastructure asset classes. Under this approach, infrastructure corporates would share the prudential treatment already in place for infrastructure corporates, for the reasons given above.

Question 1.

We not agree with EIOPA's approach of measuring the risk of infrastructure corporates on the basis of data on listed entities, and are concerned that the calibration is based on a selected sample of available market data.

A significant proportion of insurers' investment into corporate infrastructure is carried out as private placements. Insurers have stronger direct control over such assets, and would also not be exposed to short-term market volatility and general market movements in the same way as the entities selected for the sample. As well as differences in risk profiles, using the selected sample of listed entities may bias the analysis towards particular sectors that are more likely to be listed.

Generally, since around 2004 the population of listed infrastructure corporates has reduced significantly. This is mostly driven by their being bought by private unlisted infrastructure equity funds (which have insurance companies and pension funds amongst others as their LPs). These naturally long-term investors were able to pay the premium to take these companies private as (a) they valued the long-term cashflows more highly than public market equity investors, more likely to be driven by short-termist views and (b) this long-term view permitted them (generally) to allow the companies to carry higher debt burdens than listed equity companies. Again, this higher debt was deemed acceptable due to the long-term and stable nature of the company revenues, and the ability of the equity investor to take a long-term view of equity returns.

Policymakers should also consider the importance of loan structures, such as covenants, collateral, security and investment mandate parameters, rather than relying solely on historic data which may be reliable yet not always relevant.

Question 2.

(a) We do not agree that telecoms should be outside the scope.

(b) For example, the risk profile of a telecom tower or broadband company receiving concession-based revenue would be comparable to a water utility.

Section 8.4.

We propose that the requirement for sector diversification within criteria 3 is replaced with a requirement that there are protections in the company statues, regulation or covenants which ensure that the revenues will continue to meet the other conditions.

Such a requirement would better reflect business practice, where infrastructure companies' activities are often restricted by statue, regulation or debt covenant from diversifying their activity. Diversification is an important tool for decreasing risk, however this is best assessed at an overall portfolio level rather than within a single asset.

Question 4.

The ABI believes a defined sector list is not required. If corporate infrastructure was included under a unified definition alongside project finance, a more high-level definition of infrastructure could be used and a sector list would not be necessary.

We further note that the lower volatility of infrastructure corporates are more driven by the stability of revenues, than the specific sector. For example, if a telecom tower or broadband company was receiving concession-based revenue, their risk profile might be comparable to a water utility.

If, however, a sector list is used, we would suggest that the scope of qualifying social infrastructure would benefit from more clarity. For example, In particular, social housing should be clearly within scope. We would also propose to make this term more inclusive by renaming as "socially useful infrastructure".

Section 9.3.

We support the proposed amendment to the definition of the additional requirement for unrated infrastructure project debt and equity.

Thank you again for the opportunity to comment on this paper. If you have any questions or we could be of further assistance, please contact alisa.dolgova@abi.org.uk