

To: Solvency II Working Group, Long Term Investment Project Group
From: Economics and Finance Committee
Date: 15-06-2017
Reference: ECO-LTI-17-038
Subject: EC publishes DA on the treatment of infrastructure corporates

Comments

This memo provides members with a summary of the key points in the [Delegated Regulation](#) on infrastructure investments which the European Commission published on 8 June 2017. Members are informed that alongside the regulation, the EC also published an [Impact Assessment](#), containing the rationale behind its proposal.

Summary

It is important to note that the proposal put forward by the EC **significantly diverges, in a positive way, from the technical advice which the EC received from EIOPA regarding qualifying investments in infrastructure**. Two key aspects are worth noting:

- **The definition of what qualifies as investments in infrastructure corporates** – the EC approach is to avoid any sector specifications so it has opted not to explicitly define which economic sectors the infrastructure corporate investment should be part of.
- **The capital charges assigned to infrastructure corporate debt** – these are now approximately 25% lower than the current treatment under corporate bonds/loans. EIOPA had proposed to the EC that no changes should be made.

Both actions are consistent with previous Insurance Europe advocacy.

The highlights of the proposed regulation are as follows:

- **Simplified definition of qualifying infrastructure entities and a definition of infrastructure corporate investments** – the definition of “infrastructure project entity” is replaced by the term “infrastructure entity” to expand the scope of qualifying infrastructure investments. Additionally, *Article 164(b)* is added defining “qualifying infrastructure corporate investments”, thus including debt and equity investments in eg structured finance arrangements involving a corporate. Further highlights include:
 - For unrated infrastructure entities (consistent with the new EC definition), these must be active for at least 3 years to be qualified as infrastructure corporates. In cases where such entities are rated, they shall not have a credit rating lower than CQS 3, if they are to qualify under this definition.
 - Infrastructure entities which earn ancillary revenues other than from infrastructure activities will no longer automatically disqualify, provided a substantial part of the entity’s revenue is earned from infrastructure.
 - In situations where the infrastructure entity is unable to provide security to investors on all assets for legal or ownership reasons (eg the land on which a renewable energy project is constructed is leased and not owned outright), alternative debt security arrangements are now allowed for, such as step-in rights or a pledge of shares, among others.
- **A lower calibration for investments in infrastructure corporate debt and equity** – debt investments qualifying as infrastructure corporates, would receive a capital charge which is approximately 25% lower than the current capital charges for rated corporate bonds. This means the proposed calibration is broadly in line with the calibration for project finance debt. Additionally, qualifying infrastructure corporate equities would receive a charge of 36%.

Example debt calibrations include:

- A 20-year, A-rated infrastructure corporate bond would now receive a capital charge of 11.63%. Under the EIOPA suggestion, this would have stood at 15.5%.
- A 20-year, BBB-rated infrastructure corporate bond would incur a capital charge equal to 22.5%. Under the EIOPA suggestion, this would have stood at 30.0%.

Background

The changes, put forward by the EC come in the wider context of the Investment Plan for Europe, and particularly the Capital Markets Union (CMU). In 2015 the Commission proposed changes to Solvency II, aimed at identifying infrastructure as a separate risk category and proposing a more tailored capital treatment. These changes were limited to infrastructure project finance and excluded infrastructure corporates thus failing to cover projects such as airports and ports often structured as corporates rather than project finance.

The Commission raised concerns on the limited scope of changes and mandated EIOPA to pursue further investigations into infrastructure corporates. [EIOPA's technical advice](#) on infrastructure corporates was submitted to the EC in June 2016 but included limited changes and very restrictive conditions for these changes to apply, which is the reason behind the EC's decision to diverge from EIOPA's technical advice.

Next steps

- The EC has submitted its changes in the Solvency II Delegated Regulation to the EP and Council for their review.
- Both the Council and the European Parliament will have a period of 3 months (extendable by another 3 months) to conclude their evaluation and raise any objections. If no objections are raised, the Delegated Regulation will be deemed approved, will be published in the Official Journal and will enter into force shortly afterwards. Its provision would apply as of the dates indicated therein.