European Commission - Fact Sheet

NEW EU RULES TO PROMOTE INVESTMENTS IN INFRASTRUCTURE PROJECTS

Brussels, 30 September 2015

What does the Capital Markets Union have to do with infrastructure in Europe?

One of the goals of the Capital Markets Union is to help mobilise capital in Europe and channel it to the infrastructure and long term sustainable projects that Europe needs to create jobs. By amending the rules on how much capital insurance companies need to hold, the Commission is giving them incentives to invest for the long-term in infrastructure. These changes will free up millions of euros for new investment in projects like the energy pipelines, transport links and broadband rollout that are vital to maintaining and boosting Europe's competitiveness.

The European Investment Bank estimates that the EU may need up to €2 trillion in investment in the period up to 2020. Public support through measures such as the €315 billion Investment Plan for Europe (IP/15/5420) will help, but there is a clear need for more private investment in such projects in the longer term.

A major source of that investment could come from large institutional investors such as insurers and pension funds. The insurance industry is ideally placed to provide such long-term finance by investing in infrastructure projects. However, many insurers are reluctant to invest in infrastructure because they are obliged to hold a high level of capital against those investments. Currently, EU insurers have approximately €22 billion invested in infrastructure, representing less than 0.3% of their total assets.

The Commission is proposing legislation today that will modify the Solvency II Delegated Regulation to create better incentives for insurers to invest in infrastructure projects, in particular by reducing the amount of capital which insurers must hold against the debt and equity of qualifying infrastructure projects.

If insurers were to increase their investment in infrastructure to even 0.5% of total assets, which seems achievable, this would mean an extra €20 billion of investment, bringing a boost to infrastructure projects in Europe.

Why do we need to change the rules for insurers in order to boost investment?

Insurance companies are major investors. At the end of 2014, European insurers had almost €9.9 trillion invested on behalf of their policy holders. So their decisions on where to invest have a significant impact.

The rules that apply to those insurance companies have a major influence on whether or not they decide to take on long-term investments like infrastructure projects. Solvency II is the prudential framework for insurance companies in the EU. It introduces risk-based capital requirements for investments made by those insurance companies. This means that when selecting their investments (in equities, bonds, property, etc.), insurers will take into account the capital charges that apply to them under Solvency II.

Currently, an insurance company wanting to invest in a public project such as a motorway would be subjected to the same capital charge as if it invested in any private company - even though infrastructure projects generally benefit from predictable future revenues (like motorway tolls) and therefore have a better risk profile.

In view of this, the Commission has decided to change the rules under Solvency II to give insurance companies better incentives to invest in infrastructure projects.

What are the main elements of this amendment to Solvency II?

By making a number of amendments to the Solvency II Delegated Regulation[1], the Commission is primarily changing the way the rules apply to insurers' investments in infrastructure.

- The amended Regulation introduces a new concept of 'qualifying infrastructure investments': these are investments that present better risk characteristics than other infrastructure investments. Insurers will need to hold a lower level of capital against their investment in these infrastructure projects. 'Qualifying infrastructure investments' will form a distinct asset category under Solvency II and will benefit from an appropriate risk calibration, lower than that which would otherwise apply (for example the calibration of the stress factor for such an investment in equity is lowered from 49% to 30%). This will ultimately lead to a lower capital charge.

- It allows investments in European Long-Term Investment Funds (ELTIFs) to benefit from lower capital charges under Solvency II. This brings them in line with investments in European Venture Capital Funds and European Social Entrepreneurship Funds, which benefit from the same equity capital charge as equities traded on regulated markets, lower than that for other equities.
- It grants equities traded on multilateral trading facilities (MTFs) the same capital charge as equities traded on regulated markets. This ensures coherence with the new legislative framework applicable to these structures[2].
- It extends the application of a transitional measure for equity investments to unlisted equities, so that insurers will not suddenly withdraw from equity investments. It also clarifies how insurers should apply the transitional measure to equities held in managed funds.

Which infrastructure investments will qualify for a lower capital charge?

Only investments in infrastructure projects that meet the 'qualifying criteria' will benefit from the lower capital charge. The criteria will denote safer infrastructure projects and ensure that insurers understand the associated risks.

In order to qualify for these reduced capital charges, infrastructure projects must be able to generate predictable cash-flows and withstand stressed conditions. The investments can take the form of equities, bonds or loans and the contractual framework of the project should contain provisions to protect investors. Insurers must be able to hold investments in bonds to their maturity.

Can investments in innovative infrastructure projects benefit from these reduced risk charges?

It is desirable for insurers to invest in a diverse range of infrastructure projects. This is why the amendment provides for a set of qualifying criteria instead of a narrow list of qualifying industries. The qualification criteria will allow areas such as the digital single market, energy, transport and innovation to benefit from these reduced risk charges, as long as the technology has been tested.

How significant is the reduction in capital charges for qualifying infrastructure projects?

The amendment to the Solvency II Delegated Regulation provides qualifying infrastructure investments with lower calibrations in the Solvency II standard formula for the calculation of market risk.

All infrastructure equity investments will now have a risk calibration[3] of 30% of their value, compared to 49% for unlisted equities, into which category most infrastructure project equities fall; equities traded on regulated markets and MTFs (multilateral trading facilities) have a risk calibration of 39%.

The capital charge related to qualifying infrastructure investments in the form of bonds or loans has also been significantly reduced for various maturities and credit quality steps. For example for a 20-year bond with a credit quality step 3 (on a scale of 0 to 6), the revised calibration will be a 20% risk factor instead of 30%. The effective reduction of the risk calibration compared with the previous risk calibration is over 30% for bonds of credit quality step 3[4], and over 40% for unrated bonds which meet the applicable qualification criteria.

Will any other reductions in capital charges for infrastructure investments be introduced in future?

Some interested parties would like to see capital charges reduced also for investments in the debt and equity of 'infrastructure corporates'. These are companies other than special purpose project vehicles, and have a variety of activities; usually, an infrastructure investment is transferred into a corporate structure once the construction is over and the operational phase begins. This is a more complex and challenging area in which to develop qualification criteria and risk calibrations, which cannot be the same as for entities which strictly limit their activity to an infrastructure project. In view of the importance of infrastructure investments, the Commission, with the assistance of the European Insurance and Occupational Pensions Authority (EIOPA), will examine the issue of the calibration of capital requirements for this type of company structure.

How does this amendment improve the existing transitional measure on capital requirements applied to investments in equities?

Solvency II contains a transitional measure that phases out the previous equity capital charges, and phases in the new charges over a period of seven years, for equities purchased before the end of 2015. The Commission has extended the benefit of this transitional measure to all equities (previously, only equities traded on regulated markets were covered). Otherwise, the risk calibration for equities not traded on regulated markets would have moved to 49% on 1 January 2016. This amendment to extend the scope of the transitional measure will avoid an undesirable disinvestment from equities.

There is also a simplified methodology to apply the transitional measure to equities held via managed funds. As the capital requirements are supposed to be applied on the basis of the assets held by the funds, it was previously necessary to trace the date that the funds had purchased the equities, which could be excessively costly. In such cases, the amount of equities in a fund to which the transitional measure is applied can now be estimated on the basis of average data regarding the underlying composition of the funds and the evolution of its portfolio. This simplified methodology will help to reduce the cost of implementing the transitional measure.

Will this initiative help small insurers to invest in infrastructure?

The Commission welcomes infrastructure investment by all insurers, while recognising that not all insurers have the capacity in-house to fulfil the required due diligence and governance requirements for infrastructure investments. Insurers which have the expertise can invest directly. All insurers can also invest via managed funds, including in particular ELTIF funds.

How does this amendment affect European Long Term Investment Funds?

ELTIF funds are primarily equity funds that invest particularly in unlisted companies needing long-term financing, including SMEs. Equities held through ELTIFs are now to be given the same risk calibration as equities traded on regulated markets: 39%, instead of the calibration of 49% which applies to other equities.

ELTIF funds can also invest in safer infrastructure investments. The Solvency II feature known as the "look-through approach" will provide incentives to invest in such funds. For example, qualifying infrastructure equities held in ELTIF funds will benefit from a risk calibration of 30%[5].

Finally, for ELTIFs where the look-through approach is not possible, and considering the ELTIF investment rules, shares issued by ELTIFs themselves have a 39% calibration. This favourable treatment is the same as that applied to European Venture Capital Funds and European Social Entrepreneurship Funds.

What does this amendment change for investments in equities traded on Multilateral Trading Facilities (MTFs)?

The risk calibration for equities traded on MTFs will be the same as for equities traded on regulated markets: 39%. This is a consequence of the new regulatory framework applicable to MTFs, in the Regulation and Directive on Markets in Financial Instruments[6]; MTFs are now subject to similar requirements as regulated markets regarding their members and participants.

On what evidence has the Commission based its decision to make this amendment?

The Commission sought technical advice from the European Insurance and Occupational Pensions Authority (EIOPA) on whether and how to amend the Solvency II framework to take into account the specificity of investments in infrastructure. EIOPA conducted a public consultation and adopted its final technical advice on 29 September 2015. EIOPA's assessment demonstrates that debt investments in qualifying infrastructure projects have a better risk profile than was implied by their former treatment. EIOPA has also identified evidence to support the calibration for infrastructure investments in equity.

The reduction in capital charges for ELTIF investments is warranted, as explained in an impact assessment accompanying the Commission Delegated Regulation of 10 October 2014, in the same way as European Venture Capital Funds and European Social Entrepreneurship Funds. The calibration is based on the analysis of an index focusing on private equity, which showed a better risk profile than conventional corporate equities.

Will this amendment be in effect in time for the application of Solvency II on 1 January 2016?

The European Parliament and the Council have up to three months to exercise their right of objection, with the possibility to extend this period for another period of three months at their initiative. Either institution also has the right to reject the amendment. Following the expiry of this objection period, this amendment to the Solvency II implementing rules will be published in the Official Journal of the European Union and will enter into force on the day following the date of its publication.

What are the next steps? Will these changes be evaluated?

Following the application of Solvency II from 1 January 2016, the Commission will, with the assistance of EIOPA, monitor the implementation of the framework to improve it where necessary. Such improvements may be considered in the review of the Solvency II standard formula, which is due to be carried out by 2018**.**

For more information on Solvency II, please also see MEMO/15/3120

[1] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II). Official Journal L 12, 17.1.2015, p. 1–797

[2] Directive 2014/65/EU of the European Parliament (MIFID II)

[3] A risk calibration is the simulated fall in value of the asset in the Solvency II standard formula. The final capital requirement will usually be much less than 30% of the value of the equity, due to mitigating factors, especially diversification and fiscal consequences.

[4] Credit quality steps are a measure of the credit risk in investments. The Solvency II framework contains provisions to map credit ratings from credit rating agencies to credit quality steps.

[5] The final capital requirement will usually be much less than 30% of the value of the equity, due to mitigating factors, especially diversification and fiscal consequences.

[6] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, (OJ L 173, 12.06.2014, p.349), and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, (OJ L 173, 12.06.2014, p.84).

MEMO/15/5734