	Comments Template on Call for Evidence Request by the European Commission to EIOPA for Technical Advice on the treatment of unlisted equity and debt without an ECAI rating in the standard formula	**Deadline 24 May 2017 23:59 CET**
Name of Company:	Gesamtverband der Deutschen Versicherungswirtschaft e.V. (GDV)	
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-17-003@eiopa.europa.eu** **Our IT tool does not allow processing of any other formats.** The numbering of the questions refers to the discussion paper on the review of specific items in the Solvency II Delegated Regulation.	
Reference	**Comment**	
General Comment	GDV welcomes the opportunity to comment on the Call for Evidence from EIOPA aiming to remove unjustified constraints to financing in view of removing barriers to investments in unrated bonds and loans and in unlisted equity. Since excessive capital requirements unnecessarily restrict investment options for insurers, capital treatment based on the real risk allows them to invest in a risk adequate way, generating additional returns for policyholders and at the same time helping to stimulate much needed economic growth.	

	Unrated bonds and loans Bonds and loans are some of the most important asset classes for insurers in the German market. To improve investment opportunities for unrated debt we suggest primarily the following approaches: • It should be possible to use proxy ratings for unrated bonds and loans. Unrated debt may be assigned the corresponding issuer rating or the rating of comparable securities of the issuers under certain conditions. Notching should be allowed. • In addition, insurers should have the opportunity to use internal ratings. The insurer can calculate a risk-sensitive measure, especially for corporates, through the analysis of balance sheets. Insurers can calibrate the debt ratio of an unrated security within its portfolio by finding a bond or loan in the same sector with a comparable debt ratio and allocate its rating to the bond or loan. • Investment guidance for Borrower's note loans (German Schuldscheindarlehen) with financial ratios and covenants could be very useful. For German Schuldscheindarlehen, insurers use the GDV "Principles for the granting of loans to companies by insurers" (Kreditleitfaden - credit guideline) which has been coordinated with the German Federal Financial Supervisory Authority (BaFin). Private Placements analysed according to such principles like the Kreditleitfaden could also receive the risk charge for rated debt with CQS 1, 2 or 3 and could be used as best practices for the treatment of unrated borrower not loans. • Mortgage loans to retail customers (consumer loans) that meet all of the requirements of article 191 Delegated Regulation (EU) 2015/35 – except the threshold of euro 1 million – should fall under the counterparty default risk module and not under the spread risk module. Alternatively, the threshold of euro 1 million should at least be increased. • Mortgage loans to communal and cooperative housing societies should also fall under the counterparty default risk module and not under the spread risk	

	module. **Unlisted equity** With regards to unlisted equity, EIOPA would like to define criteria that would allow the identification of those instruments which could benefit from the same risk factor as listed equity. It is important to keep in mind, that each list of criteria comes with the caveat that it could become too strict and not applicable in practice. Therefore, GDV views it as important – in case such criteria will be defined – to find a pragmatic approach, which is not overly complex and cost-intensive for insurers.	
Questions on unrated debt		
Q1	**I. Concerning mortgage loans** Mortgage loans are an important asset class in the German market, especially for life insurers. Consumer loans relating to residential property under euro 1 million fall under the counterparty default risk module (as long as they meet the further requirements of article 191 para 2 to 13 of the Delegated Regulation (EU) 2015/35). In the spread risk module the following types of mortgage loans may be concerned: • Mortgage loans beyond euro 1 million • Mortgage loans to a natural person, where the property is not occupied or let by the owner • Mortgage loans to communal, cooperative or private housing societies • Commercial real estate loans **Mortgage loans beyond euro 1 million** (consumer loans): Loans that meet all of the requirements of article 191 except the threshold of euro 1 million should fall under the counterparty default risk module and not under the spread risk module. Whether a loan is granted for euro 900.000 or for e. g. euro 1.2m does not change the general risk or the risk management of the loan. In both cases the same requirements apply to the credit assessment (especially the requirements of the value assessment of the Directive 2014/17/EU) and to the assessment of the	

	property. Also the covenants and the credit hierarchy do not differ (all of these mortgage loans are generally senior loans). Therefore it is justified to delete the threshold of euro 1 million (article 191 para 4) as a characteristic for the classification in the counterparty default risk module or the spread risk module. Alternatively, the threshold of euro 1 million should at least be increased. Prices for real estate have been constantly rising over time. This leads especially in cases of loans to consumers in agglomeration areas (urban centres) to a different treatment of these loans compared to rural areas. Furthermore, there is an unequal treatment of similar consumer loans (as far as the borrower is financing for example two objects that in sum exceed the threshold of euro 1 million). We therefore consider a rigid threshold for the classification under the spread risk module as not appropriate. Further, the requirement of article 191 para 7 (the risk of the borrower may not materially depend upon the performance of the underlying property) is already met for all consumer mortgage loans due to the requirement of the Directive 2014/17/EU. **Mortgage loans to communal and cooperative housing societies**: The statutory purpose of communal or cooperative housing societies acting solely on a local basis is to provide the local population / members of the cooperative with reasonably priced housing. The policy is aimed at receiving a sustainable yield and not on short term profit maximation. Profits, to a large extent, are used for maintenance, construction of new buildings or restoration of portfolio buildings. As a consequence, such buildings are usually in a very good condition. Moreover, buildings of these housing societies have a solely residential purpose. Given the residential purpose and the fundamental characteristics, it is therefore justified to treat loans to communal and cooperative housing societies as residential property occupied or let by the owner. The risk performance of these housing societies is generally very good. According to information from credit agencies (e. g. Creditreform) communal and cooperative housing societies have generally a very strong creditworthiness profile. This is also the general finding of the review of the audit reports. Housing societies even possess partially "eligibility for central bank credit" which is awarded by the Deutsche	

	Bundesbank. Credit defaults have not occured so far. As professional holders of residential building portfolios, housing societies pursue a stable and conservative business model. Lenders examine thoroughly the documents concerning the object and the creditworthiness. Loan approval is based on analyses of the annual reports and expert opinions of the financed objects. With regards tocredit risk, business with communal and cooperative housing societies can be classified as secure and low risk. It is therefore justified to classify loans to communal and cooperative housing societies under the counterparty default risk module rather than the spread risk module. **II. Concerning Unrated bonds and loans** The spread risk, market risk concentration sub-module and the counterparty default risk module depend on the credit quality as a risk factor. The European Commission Implementing Regulation (EU) 2016/1800 suggested an implementation to map the credit quality obtained by external credit assessment institutions (ECAI) to an objective scale of credit quality steps in accordance with the Solvency II Directive.[1] The question then arises, what could be clear and conclusive criteria applicable to bonds and loans for which there is no rating by a nominated ECAI. There are generally two kinds of approaches that are possible. Firstly, criteria can be related to the financial statement of the debtor and secondly, they can be related to the position of the debtor in the credit hierarchy in case of default. One possibility could be to use proxy ratings for unrated bonds and loans. Unrated debt may be assigned the corresponding issuer rating or the rating of comparable securities of the issuers under certain conditions. It is important to ensure that Art. 5 of the Delegated Regulation (EU) 2015/35 is complied with. The following rating transfers appear possible: • The associated issuer rating is assigned to unrated debt. The transfer ensures	

[1] EIOPA-CP-16/008 – Discussion Paper on the Review of Specific Items in the Solvency II Delegated Regulation

	that only issuer ratings are transferred whose rank is equal to or less than the rank of the debt to which the rating is assigned. Notching should be allowed. • In the case of (registered) covered bonds/Pfandbriefe, which do not have a securities rating, the rating of similar rated covered bonds /Pfandbriefe of this issuer is transferred. • In case of (registered) profit-sharing certificates (Genussscheine) which do not have a rating, the rating of similar issuers of the issuer is transferred. This method is already applied in the banking sector[2] as well as in IFRS 13 Level 2. In addition, we believe that internal ratings can be used under certain conditions. The insurer can calculate a risk-sensitive measure, especially for corporates, through the analysis of a balance sheet. As an example, the debt ratio can be used as a quantitative measure for the credit quality. This is defined as the ratio of total – long-term and short-term – debt to total assets. Then the insurer can calibrate the debt ratio of an unrated security within its portfolio by finding a bond or loan in the same sector with a comparable debt ratio and allocate its rating to the bond or loan. If internal ratings (i.e. own credit assessments) can be used to determine the SCR according to the standard model or internal model the possibility of "cherry picking" has to be avoided in order not to endanger the comparability of SCR values between different companies. To this end, the following rules should be applied which have been already established for a long time in banking supervision: • Internal ratings should be subject to quantitative back-testing on a regular basis and based on a validated rating system. • The rating systems and the required validation should be submitted to the supervisory authorities on a regular basis. • The internal rating system should be designed in a way to avoid conflicts of interest.	

[2] Article 139 of the Capital Requirements Regulation (EU) No 575/2013

	• The methods of an internal rating system should be described in a detailed work instruction / rating manual. For German Schuldscheindarlehen, insurers use the GDV "Principles for the granting of loans to companies by insurers" (Kreditleitfaden - credit guideline) which has been coordinated with the German Federal Financial Supervisory Authority (BaFin). Currently, the credit guideline will be revised and adapted to Solvency II. The revised credit guideline will have clusters of financial ratios that refer to the rating scale and the methodologies of rating agencies. Private Placements analysed according to such principles like the Kreditleitfaden could also receive the risk charge for rated debt with CQS 1,2 or 3.	
Q2	**I. Concerning mortgage loans** **1. Mortgage loans to retail customers (consumer loans), that are classified dependent on their volume (under or beyond euro 1 million) in the counterparty default risk module or in the spread risk module** The criteria and methodolgogies outlined below for mortgage loans to retail customers (consumer loans), justify a classification in the counterparty default risk module. This equally applies to loans in the counterparty default risk module and spread risk module. **a. Financial state of the debtor**: • Comprehensive creditworthiness assessment according to Directive 2014/17/EU. • Loan allocation according to the loan-to-value. The lower the loan-to-value, the more secure is the mortgage loan. • The determination of the market value (or the loan to value) by specially trained employees who are not involved in the credit process. Furthermore, in case of a loan of more than euro 1 million, the valuation of the property (including an inspection) will be carried out by an independent expert.	

	b. Features of instruments (particular covenants and position in credit hierarchy) • The foreclosure covers the entire property. Accordingly, the loan is not only collateralized with the financed property or other explicitly taken collateral, such as a third party guarantee. The borrower is liable with all of his property and assets. • Mortgage loans are generally senior loans. **c. Transparency** • Full transparency to lenders is given, as the borrower must disclose all his income and liabilities in the context of the creditworthiness assessment. **2. Mortgage loans to communal and cooperative or housing societies** The criteria and methods outlined below for mortgage loans to communal and cooperative or housing societies justify a classification in the counterparty default risk module. **a. Financial state of the debtor** • Creditworthiness assessment as „pillar 1“ of the credit decision: Analysis of the annual report of the housing societies, especially analysis of the balance sheet and the income statement including identification of key indicators. • Partially classified with “eligibility for central bank credit“ which is awarded by the Deutsche Bundesbank. **b. Features of instrument (particular covenants and position in credit hierarchy)** • Loans are generally senior loans. • Declaration of subjection to immediate enforcement proceeding against the entire property. Partially a narrow declaration of purpose may be set forth. • In part, it may be that a close statement of the purpose is agreed (enforcement only in the mortgaged property):	

- Requests for information
- Review and inspection of the property as „pillar 2“ of the credit decision: Inspection reports as a basis for the determination of the market value.

c. Transparency

- Disclosure and examination of the certified test reports as well as documentation on property to be financed.

II. Concerning unrated bonds and loans

a. For German Schuldscheindarlehen, insurers used to have a guidance with three blocks of financial ratios. The previously three blocks (Interest coverage, Debt/EBITDA and Capital Ratio) will be developed further in the new guidance. Currently, the insurer can choose three different financial ratios (one ratio each block) out of the blocks. The ratios have to be fulfilled throughout the duration of the Schuldschein and changes after issuance are not allowed. The ratios have to be reviewed at least annually with the latest financial statement."

b. The German Schuldscheindarlehen documentation has to meet minimum criteria in relation to covenants. Features like negative pledge, pari passu, change of control, cross default/cross acceleration, asset disposal must be contained in the documentation.

c. If the debtor is not publicly listed (ad hoc publicity), the insurer has to be provided directly by the debtor or through the paying agent with all relevant information (incl. annual reports).

d. Bonds and loans for which no credit assessments exist have to be reviewed at least on an annual basis. In case of negative information the debtor has to be reviewed more often. If a financial covenant is triggered and/or one of the

	other minimum requirements are not fulfilled the treatment would be the same as for rated bonds or loans. Insurers also haveto review pension and leasing obligations.	
Q3	**I. Concerning mortgage loans** **1. Mortgage loans to retail customers (consumer loans), that are classified dependent on their volume (under or beyond euro 1 million) in the counterparty default risk module or in the spread risk module.** The evidence listed here justifies a classification in the counterparty default risk module. This equally applies to loans in the counterparty default risk module and spread risk module. • Amount of loan-to-value • Valuation adjustment (default rates of loans) • Amount of loss given default • Monitoring of the value of the objects corresponding to the requirements of article 191 para 9 • Evaluation of the creditworthiness of the borrower over the maturity of the loan. **2. Mortgage loans to communal and cooperative housing societies** • Identification of payment arrears and credit defaults (as far as technically possible, also retro-active) and evidence of great rarity of these events. **II. Concerning unrated bonds and loans** The clusters and triggers for the financial covenants in the GDV credit guideline refer to some extent to the methodologies of rating agencies.	

Q4	**I. Concerning mortgage loans risk** **1. Mortgage loans to natural persons (consumer loans), that are classified dependent on their volume (under or beyond euro 1 million) in the counterparty default risk module or in the spread risk module** All data is accessible to the insurer. **2. Mortgage loans to communal and cooperative housing societies** See point 1 above. **II. Concerning unrated bonds and loans** All relevant information is available in the balance sheet and the p&l of the debtor. The guidance guides the insurer through the structure and calculation.	
Q5	**I. Concerning mortgage loans** **1. Mortgage loans to natural persons (consumer loans), that are classified dependent on their volume (under or beyond euro 1 million) in the counterparty default risk module or in the spread risk module** The comprehensive creditworthiness assessment according to Directive 2014/17/EU and the survey of the property as security from a certain lending volume is also appropriate for mortgage loans beyond the threshold of euro 1 million. It justifies a classification in the counterparty default risk module. **2. Mortgage loans to communal and cooperative housing societies** Creditworthiness assessment as „pillar 1" of the credit decision. Analysis of the annual report of the housing societies, especially analysis of the balance sheet and the income statement including identification of key indicators as well as review of the property as „pillar 2" of the credit decision: Inspection expertise as a basis for the determination of the market value (respectively collateral value) leads in most cases to the following conclusion: very little / no payment arrears / failure rates. This	

	justifies a classification in the counterparty default risk module. **II. Concerning unrated bonds and loans** No comment.	
Q6	**I. Concerning mortgage loans** **1. Mortgage loans to natural persons (consumer loans), that are classified dependent on their volume (under or beyond euro 1 million) in the counterparty default risk module or in the spread risk module** **a. Characteristics of unrated debt** • Credit periods: fixed interest loans with fixed interest terms from 5 to 30 years. • Collateral requirements: collateralisation by financed property (senior mortgage). **b. Risk profile** • Evaluation of payment arrears, failure rates / losses (also retro-active). **2. Mortgage loans to communal and cooperative housing societies** • See above a., b. • Amount of loan to the housing society is dependent on the size of the housing society and of the investment policy of the insurer. • Evaluation of payment arrears and credit defaults (also retro-active) is possible. **II. Concerning unrated bonds and loans** a. Since most data is confidential it is difficult to provide reliable information. Public sources note that in the German Schuldscheindarlehen market, euro 25.4bn were issued in 2016 (2015: euro 18.6bn with 70 transactions) with 108 different transactions. The average size of a transaction in 2016 was euro 235	

	m significantly higher than in 2015 with euro 190m. Before 2015, the average size ranged between euro 120m and 130m. In 2016, 14 Schuldscheine were issued with a volume of more than euro 500m (seven transactions in 2015 – three of them with more than euro 1bn volume). Smaller issues with less than euro 20m are decreasing. Less than 20 % of the issuers are publicly listed and 48 issuers (2015: 31 issuers) were not located in Germany. Most foreign issuers came from Austria, France, Switzerland and the Netherlands. The reasons for issuing a Schuldschein are different but refinancing existing debt and M&A activities are the main drivers. The maturity of the transactions tend to range from five to seven years in 2015 and also due to the low yield environment to ten years and longer in 2016. A negative pledge is standard. The majority of the Schuldschein issues are pari passu with other senior instruments. b. Compared with the SME bond market in Germany (Mittelstandsbondmarkt) the Schuldschein market is very resistant against defaults. Defaults are very rare. The average credit quality of the issuers invested in is investment grade but the number of issuers from the high yield universe is increasing somewhat.	
Q7	**I. Concerning mortgage loans** • Specific types of mortgage loans as described above are: Consumer loans, owner-occupied home loans and loans for rental property, loans to cooperative housing societies for residential purposes (mostly loans to communal and cooperative housing societies as mentioned above), commercial real estate loans. • Degree of diversification of owner-occupied home loans and loans for rental property is very high. Loans to cooperative housing societies: Loan portfolios as such are less diversified; however, due to the large number of underlying rental arrangements and fragmented tenancy structures these investments are also highly diversified.	

	• Assessment based on payment arrears and loan defaults. **II. Concerning unrated bond and loans** Due to the high creditworthiness standards in the GDV credit guideline the unrated Schuldschein portfolio of German insurers has a very high quality and is well diversified. Most issuances are non-cyclical with constant cashflows.	
Q8	**I. Concerning mortgage loan** **All categories of mortgage loans as mentioned above:** Mostly direct investment. **II. Concerning unrated bonds and loans** The normal procedure to invest in a Schuldscheindarlehen is through an offering bank that also provides the paying agent facility and is the first lender to the issuer. The bank transfers the issue to the insurer who is the second lender. Other common ways are club deals with more than one investor or direct investments on a stand alone basis.	
Q9	**I. Concerning mortgage loan** No comment. **II. Concerning unrated bonds and loans** For German Schuldscheindarlehen the GDV credit guideline is used to provide guidance for insurers.	
Q10	**I. Concerning mortgage loans** **All mortgage loans** (counterparty default and spread risk): Average investment exposure: 4.4 % of total investments.	

	II. Concerning bonds and loans a. Total volume of all rated bonds and loans with an investment grade rating (CQS 1 to 3): euro 1,084.7bn (≈ about 90 % of all bonds and loans). No data is available for unrated bonds and loans which would qualify for an investment grade rating (CQS 1 to 3). b. About 5 % of all bonds and loans are not rated (≈ 95 rated).	
Q11	**I. Concerning mortgage loans** No comment. **II. Concerning unrated bonds and loans** It is difficult to make a general assumption about the European corporate market. But it is possible to see differences in ratios in different sectors. In the telecommunication and utility sector the leverage is traditionally high. Data from S&P shows that the adjusted debt to EBITDA in the utility sector in 2015 was at 3.8x on average. In the telecommunication sector, the adjusted debt to EBITDA in 2015 was at 3.1x on average. Both sectors are driven by huge capex programs and maintenance. In the European automotive industry, the adjusted debt to EBITDA in 2015 was at 1.2x (automotive suppliers at 1.8x). The leverage in the retail and industry sector is in a wide range. Weak investment grade credits have an adjusted debt to EBITDA in 2015 of 3 to 3.5x and strong investment grade credits have an adjusted debt to EBITDA in 2015 of 1.5 to 2x.	
Q12	**I. Concerning mortgage loans** **1. Mortgage loans to retail customers (consumer loans), that are classified dependent on their volume (under or beyond euro 1 million) in the counterparty default risk module or in the spread risk module**	

	a. Qualitative information on the borrower Creditworthiness assessment is essential for the risk assessment of the mortgage loan. Decisive for the creditworthiness assessment are the mentioned criteria. **b. Comparative Information on the borrower** Comparison of consumer loans in the counterparty default risk module and in the spread risk module (> euro 1 million) would show no special features that would justify a different treatment. **2. Mortgage loans to communal and cooperative housing societies** **a. Qualitative information on the borrower** Creditworthiness assessment as „pillar 1" of the credit decision as well as review of the inspection of the property as „pillar 2" of the credit decision very relevant for the risk assessment of the mortgage loan. **b. Comparative Information on the borrower** Due to the similar object of business certain comparisons can be drawn, e. g. concerning credit agency information (CR-Index), vacancy rate, fluctuation quota, certain blance sheet positions (e. g. equity ratio). **II. Concerning unrated bonds and loans** a. The mentioned information is essential for a full review of the company. The information completes the picture from the quantitative side of balance sheet and p&l. It is important to have access to this information throughout the whole duration of the Schuldscheindarlehen. Insurers always look at peers during the credit analysis. A comparative analysis is key to find the reasonable pricing.	

Q13	**I. Concerning mortgage loans:** a. The data required for the application of the internal model should be available or could be identified. b. The know-how that is needed has to be defined and it has to be checked whether it is available. c. Review by means of corresponding evidence by the insurer, potentially supported by audit certificate. **II. Concerning unrated bond and loans** a. n/a b. n/a	
Questions on unlisted equities		
Q1	No comment.	
Q2	No comment.	
Q3	No comment.	
Q4	No comment.	
Q5	No comment.	
Q6	No comment.	
Q7	No comment.	
Q8	No comment.	
Q9	Investments in unlisted equities are realised both via direct investments and investments in (specialized) funds. Funds investments are well suited for diversification reasons, e. g. funds themselves are often well diversified with regards	

	to companies. In addition ,investors benefit from the expertise of the often highly specialized fund managers. Total investments of German primary insurers in private equity as of 31.12.2016 are euro 13.6bn. This represents about 1 % of total investments. This figure includes direct investments and private equity investments held via funds. With regards to investments of German insurers in ELTIFs, EuVECAs or EuSEF funds, we do not have any figures, but the allocation seems to be insignificant. In Germany most private or venture capital funds are established as closed-end Alternative Investment Funds (AIFs) which are marketed exclusively to professional and semi-professional investors. Such AIF are suitable and efficient investment vehicles for institutional investors like insurers and meet their specific needs. From an investor's point of view, lower capital requirements for ELTIFs, EuVECAs or EuSEFs do not compensate for the disadvantages of such vehicles, such as rather strict requirements regarding eligible assets and portfolio composition.	
Q10	A due dilligence is done in advance of an investment decision. Investment decisions are made within the framework of the investment strategy. The internal risk management is involved in investment decisions and examines criteria such as for example: - Solvency II - Risk capital requirements - Performance assessment and attribution - Asset Liability Management - ALM - CRA III / rating process / credit rating - Thresholds - Liquidity - Reporting tools - Integration into IT infrastructure - Ongoing assessment	

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Q11	Diversification takes, for example, place at the fund level and respectively at the investment vehicle level. Especially funds investments are well suited to ensure a proper diversification, because funds themselves are often well diversified with regards to target companies. Thus, an appropriate diversification can be achieved with relatively small investments.	
Q12	Investors negotiate in advance of the investment decision the contractual terms of the investment. Hereby it is also negotiated, which information is needed at the outset of the transaction and afterwards and at what frequency.	
Q13	These factors and their relevance for the specific investment are usually to be discussed in advance of an investment decision, while negotiating the contractual terms. The implementation varies widely, depending on the individual focus of the investor with regard to these aspects.	
Q14	No comment.	
Q15	No comment.	
Q16	No comment.	
Q17	No comment.	
Q18	No comment.	