Association for Financial Markets in Europe

Briefing Note

Capital requirements for infrastructure and other investment financing

July 2016

Specialised lending transactions are an important asset class for financing infrastructure and assets, including transport infrastructure (roads, railways, etc.) and assets (aircrafts, ships, etc.), health and social infrastructure (hospitals, schools, etc.), environment and energy infrastructure (power plants, water treatment centres), telecom infrastructure (stateliest, etc.) and commodities (oil & gas, metals and minerals, agriculture, etc.).

Specialised lending exposures are specifically defined in the Basel and CRD frameworks and, according to the EBA, European banks had specialised lending exposures of over €1 trillion in Q3 2014[1]. Particularly where capital market alternatives are still developing, specialised lending is a particularly important tool for financing investment.

On average, specialised lending has exhibited low risk levels, particularly when carried out and monitored by specialised, expert teams within banks. This is due to a combination of the expertise of the teams carrying out the business and the tailored, structured and collateralised nature of these products. For example, for project and object finance, structures are put in place so that the lender controls the cash flows generated from the underlying asset(s) and/or benefits from the security of the asset itself. Banks also benefit from diversification across their specialised lending portfolios, where the values of different infrastructure assets, aircraft, vessels, rolling stock and various commodities are not correlated.

Given their bespoke, structured nature, these specialised lending transactions are inherently ill-suited to the removal of internal risk modelling and the standardisation being proposed by the suite of Basel proposals currently under consideration[2]. Moreover, many data sources related to these exposures are available, including pooled default and loss data, but also information related to the assets and industries relevant in this business area. This data enables banks to model these exposures accurately.

While we understand that the Commission is not envisaging the implementation of the above Basel proposals into EU legislation at this point in time, it is essential that going forward the risk sensitivity of the capital framework be preserved. If internal modelling is removed, the link between capital requirements and underlying risks will be broken, with particularly negative impacts on the high quality deals at the lower end of the risk spectrum. This will prevent financing volumes of this asset class being maintained at current levels.

We note also that markets are likely to expect compliance with Basel standards regardless of their jurisdictional implementations. This is especially true for the larger, international players who are amongst the main providers of this form of finance.

We therefore recommend that consideration be given to introducing a form of recognition of the importance of retaining internal modelling for project, object and commodities finance in the forthcoming legislative proposals (CRD5/CRR2) to secure risk sensitivity for this economically important exposure class.

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[1] EBA consultation on slotting criteria for specialised lending, COREP data Q3 2014
[2] We refer here to the Basel IRB constraint proposals, the revised standardised approach for credit risk proposals and proposals to introduce an aggregate output floor