PensionsEurope response to the Capital Markets Union consultation

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About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace pensions. Some members operate purely individual pension schemes. PensionsEurope Members are large institutional investors representing the **buy-side** on the financial markets.

PensionsEurope has **24 member associations** in EU Member States and other European countries with significant – in size and relevance – workplace pension systems[1].

PensionsEurope member organisations cover the workplace pensions of about **62 million European citizens.** Through its Member Associations PensionsEurope represents more than **€ 3.5 trillion of assets** managed for future pension payments.

PensionsEurope also has **25 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has establishes a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

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[1] EU Member States: Austria, Belgium, Croatia, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg,
Netherlands, Portugal, Romania, Spain, Sweden, UK. Non-EU Member States: Guernsey, Iceland, Norway, Switzerland.

1. Beyond the five priority areas identified for short term action, what other areas should be prioritised?

PensionsEurope particularly welcomes priority number 4: Boosting Long Term Investment. In the Green Paper, the European Commission refers to the establishment of the European Fund for Strategic Investments (EFSI) and the recently finalised European Long-Term Investment Funds (ELTIFs) regulatory framework.

It should however be noted that 'Boosting Long Term Investment' is a much broader topic, which could better be described as creating a long term investment friendly environment. Areas are:

- What are best-practices for regulatory and supervisory frameworks in Member States which are more conducive to long term investments? As a general rule, prudential regulation and supervisory frameworks should encourage long term investments. We should not unduly lock capital in the pension funds, which could be put to more productive use.
- The European Commission should also consider effects of financial market regulation on pension fund investments (see further, the answer provided to question 10). Regulatory projects (such as the FTT) which are not aligned with the objectives of the CMU and discourage (instead of encourage) long term investment should be dropped.
- Unfavorable treatment (prudential, solvency, taxes , etc.) of long-term investment asset classes such as infrastructure projects should be addressed by Member States.
- Pension funds need to have a stable long-term investment environment. This requires long term stability in public policy. Political risks (i.e. changes in policy with adverse effects on investments) discourage long term investments in the real economy, such as in infrastructure. The European Commission should introduce measurements to reduce political risks. Safeguarding of legal certainty is of great importance, in particular for long-term cross-border investments.
- There is a risk that European/government funding could crowd out private investments, since the risk margin charged on European/government funding is lower than private investors can afford to charge. The EFSI should only fund projects where no private funding is available on reasonable terms (nonetheless, involvement of institutions such as the EIB is helpful).

- The interaction between the current monetary environment and regulatory frameworks should be considered by Member States. The regulatory framework forces pension funds in holding very substantial allocations in low-yielding government bonds.
- The Shareholder Rights Directive should improve the attractiveness of EU capital markets and not make it more difficult or costly for pension funds to invest.
- Encouraging channeling savings into long term investments – e.g. by promoting workplace pensions in the European Union. Freedom of investment is crucial for the degree of trust of both sponsors and beneficiaries in pension systems. Governments should never disappoint this trust by raiding pension funds or forcing pension funds to invest (or divest) in certain projects, regions, etc.

2. What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?

Many pension funds already invest in (non-listed) SMEs and start-ups, mainly through funds and private equity.

The lack of standardization and transparent information constitutes an important barrier to the alternative investments made by pension funds (e.g. investment in non-listed companies such as SMEs, private equity and private debt, real estate, infrastructure). The creation of specific alternative investment categories combined with the development of a common minimum set of comparable information for credit reporting and assessment, as well as the standardization of such information would represent a fundamental step to support investments (in terms of both availability and costs).

It should be noted that a higher degree of standardisation does not necessarily require higher standards – in particular for institutional investors. Furthermore, in the case that standardization leads to lower performance indicators, European and national institutions should take steps to ensure that investments are attractive for investors.

In addition, delegated acts such as in Mifid II should not further limit the information on SMEs available to investors.

Nonetheless, in the case of SMEs it should also be stressed that pension funds neither can nor will replace the role of banks in the financial system. Banks possess (local) expertise which allows them to assess local markets and manage risks and often have multi-product relationships with their clients.

3. What support can be given to ELTIFs to encourage their take up?

PensionsEurope welcomes the introduction of the European Long-Term Investment Funds (ELTIF). Pooled investment vehicles such as ELTIF could be attractive for IORPs, especially for smaller and medium-sized ones. These IORPs may particularly benefit from economies of scale and access to asset-specific knowledge and expertise. Pooled investment vehicles are important for smaller IORPS so that they can invest in long-term projects without jeopardizing the diversification of their asset allocation. Furthermore, by pooling existing knowledge, institutional investors may profit from each other's expertise in different areas so that all of them stand to gain from a pooled investment vehicle.

The take-up of ELTIFs could be encouraged by:

- Favourable treatment in prudential and tax regulation;
- Making their added value more well-known to pension funds and their asset managers. I.e. What advantages offer ELTIFs compared with other types of funds?;
- The application of capital requirements (including the Holistic Balance Sheet) would limit IORPs investment in ELTIFs, requiring high capital requirements in case of investment in illiquid assets.
- A stricter practical separation of retail-ELTIFs and those for institutional investors

4. Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?

PensionsEurope welcomes the fact that market participants are taking the lead on this issue and are developing their own tools aiming at supporting and developing European private placement markets.

The European Commission could consider national examples. In Germany, the documentation of private placements as promissory notes has been established itself as a standard.

For the private placement market to really develop, it is important to assure that relevant capital requirements do not negate potential return on investment. For example, this is the case for 'unrated' debt instruments, which have become unattractive due to the ensuing capital requirements, whereas inherently they may be good investments.

5. What further measures could help to increase access to funding and channeling of funds to those who need them?

PensionsEurope strongly supports the development of workplace pensions within Member States. In itself, this would contribute to channelling savings (through pension funds as institutional investors) into capital markets in Europe. Pension funds, as institutional investors, already invest a large share of their assets in the European economy.

To boost the development of funded pension schemes, freedom of investment is crucial. Pension funds invest in the interest of their beneficiaries, making investment decisions based on the nature of their liabilities and the risk-return profile of assets. Investments have to be in line with the interests and the objectives of the fund. Therefore pension funds should never (either directly or indirectly**)** be urged or obliged to invest (or divest) in specific projects, asset classes or in particular locations. Member States and the European Commission should further support the principle of investment freedom.

The organization of pension systems is a Member State competence. As a result, the European pension fund sector is very diverse. There is not a single European investment culture for pension funds. Pension funds from different Member States differ widely in size, investment beliefs and strategy, form of liabilities (DB /DC), etc. In some Member States sponsor companies with legally or non-legally binding sponsor obligation are an important part of the pension system. Some pension funds are able to build specific (in-house) capacity and the knowledge required for e.g. infrastructure investment or private equity investments, while other pension funds are less able to do so and have to rely more on external expertise.

Therefore, the barriers that pension funds encounter when investing differ. The CMU should not promote a particular investment culture or trend, but should instead recognize the variety of investment cultures and aim to facilitate all of them within the CMU. Only then will the CMU reach its full potential. The European Commission could promote sharing of best practices in different types of pension fund investments.

Imposing inappropriate quantitative measures or capital requirements on pension funds (e.g. in the context of IORP or the Holistic Balance Sheet) and imposing a short term risk free discount rate to value liabilities would have negative effects on the investment capabilities of pension funds.

In addition, infrastructure investment could be further facilitated. PensionsEurope's position is described in the answer to question 10. Treatment of infrastructure investments should be appropriate.

6. Should measures be taken to promote greater liquidity in corporate bond markets, such as standardisation? If so, which measures are needed and can these be achieved by the market, or is regulatory action required?

At this point, there is no general need for further EU regulatory action in the field of standardization in the corporate bond market, as market participants could take the initiative.

However, the European Commission could look at initiatives in Member States. IORPs in Germany have had positive experiences with the covered bond legislation (Pfandbriefrecht, Pfandbriefgesetz), which is a good example for legal certainty, standardisation and therefore cost efficiency.

7. Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?

Pension funds play an important role in the field of ESG investment. Although social gains cannot substitute financial returns (the first and foremost objective of pension funds is to secure income for their members in retirement), many pension funds acknowledge that ESG factors are important for both current and future generations. Therefore, there are pension funds that are increasingly searching for investment opportunities that also address major societal challenges such as climate change. Pension funds aim to add value by ensuring their capital is engaged capital. To facilitate ESG investments, regulatory and policy stability is of utmost importance. Long-term investments in for example renewable energy will only take place in a stable regulatory and policy environment.

In addition, the European Commission could play an important role in promoting the development and use of existing standards. Standards are useful and necessary with regard to the assessment of sustainability and governance performance in all asset classes. We would also welcome further work on developing common standards for infrastructure investments. As ESG-factors are also part of risk-management for pension funds, such standards enable them to take such aspects into account. These standards should not lead to a restricted investment universe.

10. What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

Pension funds are potential 'natural' long term investors, due to the long maturities of their liabilities. Under the right conditions, pension funds' capital can contribute to the development of the real economy and drive growth by making long term investments (NB. Pension funds will also make medium and short term investments, e.g. for the purpose of liquidity management. Furthermore the principle of freedom of investment needs to be stressed: first and foremost, pensions funds responsibility is to provide pensions).

<u>On regulation</u>

Imposing inappropriate quantitative measures or capital requirements on pension funds (e.g. in the context of the IORP directive or the Holistic Balance Sheet) and imposing a short term risk free discount rate to value liabilities would have negative effects on the investment capabilities of pension funds. They could discourage the development of occupational pension schemes which are important channels of finance for the European economy. Regulation should not unduly lock capital in the pension funds. Furthermore, increasing costs of pension schemes will leave less capital available for investments in the European economy.

- As a general principle, prudential regulation applying to pension funds should not discourage long-term investments. At the moment, there are many examples of national prudential regulation or supervision that discourages long-term investments, by focusing on short-term liquidity and too strictly regulating ('punishing') illiquid assets. This is not sufficiently in accordance with the nature of the liabilities of pension funds, and may excessively limit asset allocation to long-term investment categories. PensionsEurope therefore calls on the Member States to identify and remove barriers for long-term investment in their national prudential regulation and supervisory frameworks.

- The regulations applying to institutional investors which require a systematic use of a mark-to-market valuation should be reviewed, where they do not, in the best possible way, support long term investments.
- Furthermore, there are examples of unfavourable treatment of long-term investment asset classes such as infrastructure projects in national regulation (including unbalanced risk weights versus other asset classes). Member States could provide tailored solutions for these categories.
- The interaction between the current monetary environment and regulatory frameworks should be considered by Member States. The regulatory framework forces pension funds into holding very substantial allocations to low-yielding government bonds.
- PensionsEurope is concerned with EMIR and FTT – because both initiatives are likely to increase the costs of pensions, and these costs eventually have to be paid by pensioners. As a result, pension benefits will decrease or contributions needs to be increased – with negative effects on the economy.

<u>On infrastructure investment</u>

Pension funds are already important investors in infrastructure (both directly and indirectly). Specific issues are:

- There is a shortage of operational projects that offer an attractive investment propositions. Pension funds are cautious investors which will most of the time only want to invest in the phase where risks are lower. Institutions such as the EIB could be helpful in increasing the attractiveness of projects.
- An alternative is the development of Public Private Partnerships with a DBFMO (Design Built Finance Maintain Operate) approach. These types of projects are currently mainly found in the UK and the Netherlands.
- In general, large (well structured) infrastructure projects have little difficulty attracting finance. Small / medium sized projects do often lack scale which makes the effort required to invest is higher and the investment therefore less attractive.
- Standardization, documentation and data matter – and could make this asset category more attractive (in terms of risk-assessment and costs) for pension funds.

- Political and regulatory risks matter. Often, government policy is important in decisions on infrastructure projects. There are many examples, e.g. in the field of sustainable investment, where governments have changed policies which affects investments which were decided based on the original government policy.

Treatment of infrastructure investments within regulatory and solvency frameworks should be appropriate. Furthermore, for pension funds in some Member States a proper framework (e.g. legislation, supervision) for investment in infrastructure is currently missing, which constitutes a serious obstacle for infrastructure investment.

The pension fund sector is very diverse. While in recent years some large pension funds have built in-house capacity with infrastructure investment, especially small and medium sized pension funds face a challenge as they lack the expertise necessary when dealing with infrastructure investments. On the other hand, large pension funds want infrastructure investments to have a certain scale, which is not always there. Because of this diversity, tailored responses are key. In the UK the Pensions Infrastructure Platform is a good example of how knowledge and experience about infrastructure investments are shared. The advisory hub and technical assistance in the EU Investment Plan could also help.

Furthermore, using a consortium among small sized pension funds reasonably help overcoming some obstacles to the investment in infrastructures, as it allows an adequate mass of assets to be profitably invested, be the place to develop and share skills and know-how and develop economies of scale.

The EU can make a significant contribution by ensuring a strong, transparent pipeline of suitable investment opportunities. This could take the form of a transparent list of infrastructure projects – with the right level of detail required by pension funds to do due diligence and assess the risks or returns in a particular investment opportunity.

<u>On standardization and transparency</u>

The lack of standardization and transparent information constitutes an important barrier to the alternative investments made by the pension funds (e.g. investment in non-listed companies, SMEs, private equity and private debt, real estate, infrastructure). The creation of specific alternative investments categories combined with the development of a common minimum set of comparable information for credit reporting and assessment, as well as the standardization of such information would represent a fundamental step to support investments (in terms of both availability and costs).

In particular, investments in (some parts of) real estate and infrastructure could benefit from standardisation. More standardisation could also positively affect the demand for securitisation, such as Asset Backed Securities. One example where this has happened is in the residential mortgage-backed securities (RMBS) market. Standardisation has played an important role in this market in increasing the attractiveness of RMBS investments.

Harmonization of accounting / reporting standards for SMEs could lower costs and facilitate potential investors in their investment decisions.

Securitisation

PensionsEurope supports the Commission's initiative to develop an EU framework for simple, transparent and standardized securitization. Please note that a more detailed discussion of this topic is provided for in PensionsEurope response to the consultation about securitisation.

First and foremost, we believe that a new EU securitization framework should be internationally consistent. Hence, we suggest to align any future EU legislative measure with international recommendations.

An EU framework could open capital markets finance for e.g. SMEs – and under the right conditions create an asset class for institutional investors such as pension funds. However, securitisation shouldn't be a matter of simply taking loans off bank balance sheets and selling them on to pension funds, but should be a tool to facilitate co-financing of loans by banks and pension funds.

Secondly, it is important to increase the transparency of data and their availability for investors, especially considering the complexity of securitizations.

Thirdly, it is crucial to minimize due diligence costs for investors in order to improve the attractiveness of securitization market for pension funds.

The removal of structural barriers might enable those pension funds that are willing to participate in the securitisation markets, to do so. The European Commission could take action to remove these barriers, for instance by clarifying rules and wider ratios for securitisation assets (e. g. ABS), decreasing due diligence costs for ABS investments, requesting originators do make available relevant information consequently in order to facilitate due diligence by investors, improving legal certainty, improving the disclosure rules.

Nonetheless, please note that some pension funds currently want to reduce their exposure to complex products and asset classes, and they expect securitized products to remain highly complex. Therefore, alternative options such as private placements could be considered as well.

Finally, we would like to stress that this and other Commission's upcoming initiatives and policy measures should be aligned with the objective of creating a CMU. In this context, we are concerned that EIOPA's on the Holistic Balance Sheet will discourage the participation of pension funds in this market.

12. Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?

Treatment of infrastructure investments by IORPs is regulated in national regulatory and supervisory frameworks. As a general rule, treatment of infrastructure investments within regulatory and solvency frameworks should be fitting: no disproportional capital charges or other regulation.

Furthermore, for pension funds in some Member States the practical know-how framework (e.g. experience with legislation, supervision – for both pension funds and supervisors) for investment in infrastructure is currently missing, which constitutes a serious obstacle for infrastructure investment.

13. Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

In April 2014 PensionsEurope published a position paper on personal pensions. PensionsEurope supports the development of a strong EU framework of supplementary pension savings. Such framework must clearly differentiate between the three so-called pillars (state, workplace, and personal pensions), ensuring that all the existing national regimes are taken into consideration.

It is PensionsEurope's view that state and workplace pensions should provide the bulk of the retirement income, as they have advantages compared to personal pension products. However, third pillar retirement products can also be a useful instrument to further top up the retirement income in a customized, individual way and contribute to securing the future adequacy and sustainability of retirement income. Also, some people don't have access to workplace pensions and could save for retirement with personal pension products. In order to achieve this goal, it is of key importance to adequately define the scope of personal pension products, clearly differentiating them from workplace pensions.

Furthermore, PensionsEurope notes that personal pensions tend to be individual contracts with individual investment accounts and therefore have a more limited ability to invest in illiquid assets.

15. How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

Alternative investments such as in private equity and venture capital require specific knowledge and expertise. The pension fund sector is very diverse, specific knowledge and expertise is therefore not available at every pension fund. Because of this diversity, tailored responses are key.

On the other hand, the private equity industry could take steps to improve its attractiveness as an asset class for pension funds. For example by providing more transparent reporting, developing a stronger relation between costs and returns and providing more insights into ESG performance.

In the UK private equity is currently not a suitable asset class for DC schemes. Because of scale, but also because the pricing of private equity investments is not compatible with a world in which government-imposed charge caps will increasingly push DC pension schemes into passive and 'vanilla' investments. However, the impact of auto-enrolment means that we can expect the volume of assets managed in the UK's DC schemes to grow rapidly. One independent forecast predicts DC assets growing from £277 billion (around €384 billion) today to £787 billion (1.09 trillion) by 2024. So it is vital that policy-makers ensure policies are 'future-proofed' so they are suitable for DC schemes' investment requirements once their scale has substantially increased.

16. Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

There are impediments to increasing safe non-bank direct lending to companies that need finance. The obstacles are mainly of regulatory nature, such as supervisory requirements regarding the processes around asset allocation and asset monitoring, or in the case of Solvency II the requirements for own capital.

18. How can the ESAs further contribute to ensuring consumer and investor protection?

See also question 25 for PensionsEurope's position ons ESA's.

Workplace pensions should not be regarded as merely financial or even investment products, as they may also be a part of employment conditions laid down in (collective) labour agreements. In some Member States, pension funds have a social mandate, involve social partners, and are subject to Social and Labour Law. In these cases, social and labor law often provides for a high degree of protection for scheme members. Therefore, consumer protection rules should be tailored to their objective.In contributing to investor protection, we believe pension funds, as investors, should be better represented at the ESAs, for example as participants in stakeholders' groups.

19. What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

PensionsEurope has no position on retail investment but would like to emphasize that many European citizens – although indirectly – already are active on capital markets with their savings invested in pension funds (institutional investors). Supporting the development of pension savings and funded pension schemes would therefor constitute a much better (and easier) way to increase flow of capital into capital markets, then policy measures to increase retail and household investments.

21. Are there additional actions in the field of financial services regulation that could be taken to ensure that the EU is internationally competitive and an attractive place in which to invest?

PensionsEurope calls upon the Commission and Member States to refrain from developing an FTT, because of the extra costs it would impose on pension scheme members. This implies either lower benefits or increasing contributions by employees or employers (which will also have negative effects on the economy). Furthermore; an FTT, if implemented, will not only be detrimental to pension funds but for the entire European capital markets. In fact, the introduction of an FTT would have adverse impacts in the attractiveness and competitiveness of the European capital markets, both to international and EU investors.

Furthermore, the European Commission should renounce EIOPA's proposals for a Solvency II-based Holistic Balance Sheet for IORPS and ensure capital requirements do not penalise long-term investment in infrastructure and other long-term assets.

When considering relevant financial market regulations, our general approach is that they ought to take into account the specific characteristics of pension funds. A one size fits all approach ignores important differences between markets and market players.

24. In your view, are there areas where the single rulebook remains insufficiently developed?

Pension funds have a need for a stable regulatory environment. Rather than introducing new regulation, the European Commission should evaluate the existing regulation and assure that regulation that currently is being implemented (such as EMIR) does not discourage long term investments by pension funds.

Furthermore, the cumulative impact of financial market regulation on pension funds needs to be considered and appropriate legislative modifications should be proposed: hereby lowering the administrative and regulatory costs for pension funds and their asset managers.

25. Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a Capital Markets Union?

PensionsEurope is concerned with some activities of EIOPA, which seems to be extending its activities (e.g. on the Holistic Balance Sheet) without sufficient accountability towards stakeholders or political institutions. EIOPA's accountability should be increased.

In general, we would like to call for more transparency within the supervisory processes, a proper cost-benefit analysis of the impact of EU regulation on pension funds, and to provide stakeholders at least the standard of three months to respond to consultations (some of which are highly technical).

Furthermore, we stress the character of pension provision as part of social and labor law. Regarding occupational pensions it was not clarified and precisely defined which tasks and competences an EU supervisory authority should or could (considering the crucial role of national social and labour law for key questions regarding the design of occupational pensions) have.

27. What measures could be taken to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

Reforms in this area should recognise the particular circumstances of long-term investors. Pension funds hold only small amounts of cash, so posting substantial amounts of collateral presents a major challenge. This was recognised in the European Commission's recent report on the pensions industry's readiness for central clearing under EMIR, which recommended extending the pension schemes exemption until August 2017.

Any reform in the area of collateralisation should dovetail with the EC's forthcoming review of EMIR.

28. What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?

In its position paper from September 2014 PensionsEurope has welcomed the Commission's aim to encourage and facilitate long-term shareholder engagement with investee companies through the Shareholder Rights Directive; an engaged shareholder base alongside high standards of governance, transparency and protection of minority shareholder rights should enhance the attractiveness of the EU market for both investors and issuers, and as such play a role in driving economic growth across Europe. However, some concerns remain in relation to the proportionality of the revised proposal, mainly in relation to enhanced voting rights and the investment strategy. In other words: The Shareholder Rights Directive should improve the attractiveness of EU capital markets and not make it more difficult or costly for pension funds to invest.

30. What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

PensionsEurope calls upon the Commission and Member States to refrain from developing an FTT, because of the extra costs it would impose on pension scheme members. This implies either lower benefits or increasing contributions by employees or employers (which will also have negative effects on the economy). See further our answer to question 21.

The European Commission should make sure that (international) initiatives such as the OECD-project Base Erosion and Profit Shifting (BEPS) does not include inadvertent consequences that negatively affect long term investments by pension funds, such as in infrastructure funds.

In particular, the emergence of a pan-European capital market would require more transparency and clarity as to which jurisdictions apply in cases of insolvency. This would allow institutional investors to assess the risks to their portfolios, and thus enhance their investment decision-making, especially in cross-border situations.

With regard to double taxation treatments of IORPs, as well as their investment funds, we suggest to remove existing impediments to the practical enforcement of double taxation claims.