PensionsEurope answer to the EC consultation on the EU macro-prudential framework

October 2016

www.pensionseurope.eu

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 **70 million European citizens.** Through its Member Associations PensionsEurope represents more than **€ 3.5 trillion of assets** managed for future pension payments.

PensionsEurope also has **26 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 established 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.

Contact:

Mr Matti LEPPÄLÄ, *Secretary General/CEO*
Koningsstraat 97, rue Royale – 1000 Brussels
Belgium
Tel: +32 (0)2 289 14 14 – Fax: +32 (0) 289 14 15
matti.leppala@pensionseurope.eu
www.pensionseurope.eu

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

Introduction

PensionsEurope welcomes the opportunity to answer to the European Commission's consultation on the review of the EU Macro-prudential framework.

In our contribution we answered in total to six questions: 1, 2 ("a" and "b"), 29, 31 (only explanation), 32 and 33. PensionsEurope skipped many of the questions that were purely about the banking sector.

To summarise, PensionsEurope answer stresses that:

- Policy coordination of the ECB and ESRB with the Commission, European Parliament and Council should be improved to ensure financial stability. However, PensionsEurope urges to refrain from using tools or implementing measures beyond banking without evidence of systemic risk;
- Due to their long-term investment perspective, pension funds pose low risk to global financial stability. Pension funds' main investment choices are not significantly affected by temporary fluctuations of the markets. In addition to this, the regulatory framework requires that pension funds are transparent, low leveraged and diversified with prudence;
- Secondly, pension funds have limited short-term liquidity needs, which make them more inclined to buy and hold assets across the entire economic cycle. They also have an ability to behave counter-cyclical;
- As pension funds pose no systemic risk, there is no need to include pension funds in the ESRB work;
- Statistical reporting requirements should be coordinated. PensionsEurope does not see the merits of the envisaged ECB Regulation on statistical reporting requirements for pension funds;
- The impact of QE on pension funds needs further investigation;
- The current structure and organisation of the ESRB doesn't ensure that it is an independent body;
- The ESRB should not impose a bank-bias approach to other financial sectors.

Question 1:

Do you consider the degree of coordination between the different authorities in the current framework (i.e. ESRB, national macro-prudential authorities, Commission, Council, etc.) appropriate?

Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all).

- ○ 1 (fully appropriate)
- ○ 2
- ◉ 3
- ○ 4
- ○ 5 (not appropriate at all)
- ○ Don't know / no opinion / not relevant

Please explain your scoring:

PensionsEurope considers that the EU macro-prudential coordination between the Commission, European Parliament, Council, ECB, ESRB, EIOPA, EBA and ESMA to be improved in the following areas:

- Policy coordination of the ECB and ESRB with the Commission, European Parliament and Council should be improved to ensure financial stability. While the European Commission is focused in building up the Capital Markets Union, the ECB's Quantitative Easing, even though useful to strengthen economic recovery, has negative effects on the stability of pension funds as it triggers to a mismatch of the duration of assets and liabilities.
- Statistical reporting requirements should be also coordinated. In addition to national requirements to provide statistics, the ECB is considering issuing new requirements for data from pension funds. This would increase the workload for pension funds significantly if they differed – even if only slightly – from existing national requirements. PensionsEurope does not see the merits of the envisaged ECB Regulation on statistical reporting requirements for pension funds. Pension funds should not be required to directly submit any statistical data to the ECB, as the ECB should be able to ask statistical information from EIOPA or national supervisors.
- PensionsEurope stresses that any additional reporting obligations on EU level directly imposed on pension funds that would lead to a double reporting by pension funds (i.e. reporting to national supervisors/reporting to the ECB), with different contents and/or forms, should be avoided as it would impose additional costs to pension funds. To make the most of their members' contributions, many pension funds are run by relatively small teams. The overload on reporting obligations would not be in accordance with Articles 3[2] and 3a[3] of

[2] Article 3 of Council Regulation (EC) 2533/98 of 23 November 1998: […]"Without prejudice to the fulfilment of its statistical reporting requirements, the ECB:
(a) shall use existing statistics as far as possible;
(b) shall take into account the relevant European and international statistical standards;

Council Regulation (EC) 2533/98 of 23 November 1998, concerning the collection of statistical information by the European Central Bank.

Question 2:

(a) Would you consider appropriate to expand the macro-prudential framework beyond banking?

Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all).

- ◯ 1 (fully appropriate)
- ◯ 2
- ◯ 3
- ◉ 4
- ◯ 5 (not appropriate at all)
- ◯ Don't know / no opinion / not relevant

Please explain your scoring:

PensionsEurope urges to refrain from expanding the EU macro-prudential framework beyond banking without evidence of systemic risk in other sectors.

As noted by the Financial Stability Board and the Bank of England[4] pension funds contribute to the stability of the financial system due to their long-term horizon and the fact that their main investment choices are not significantly affected by temporary fluctuations of the markets.

First of all, the failure or financial distress of pension funds, in principle unlikely, does not pose systemic risks because the financial risks related to pension funds are borne by their plan members and sponsoring companies. Pension funds should be fully funded and in case of underfunding different options exist in order to mitigate the consequences of a pension fund's failure. The potential systemic risks are usually avoided by increasing the pension fund's funding position, by decreasing the value of pension benefits, increasing premiums or by the no indexation of pensions' decision. Consequently, in case of financial distress, other institutions do not bear risks, as these are borne by the plan members and employers.

(c) may fully or partly exempt specific classes of reporting agents from its statistical reporting requirements. Before adopting a regulation as referred to in Article 5 concerning new statistics, the ECB shall assess the merits and costs of the collection of the new statistical information in question. It shall in particular take into account the specific collection characteristics, the size of the reporting population and the periodicity, and the statistical information already held by the statistical authorities or administrations".

[3] Article 3 a of Council Regulation (EC) 2533/98 of 23 November 1998 "The development, production and dissemination of European statistics by the ESCB shall be governed by the principles of impartiality, objectivity, professional independence, cost-effectiveness, statistical confidentiality, minimisation of the reporting burden and high output quality, including reliability and the definitions of these principles shall be adopted, elaborated on and published by the ECB. These principle are similar to the statistical principles of Regulation (EC) No 223/2009 of the European Parliament and of the Council of 11 March 2009 on European statistics".

[4] "Procyclicality and structural trends in investment allocation by insurance companies and pension funds: A Discussion Paper" by the Bank of England and the Procyclicality Working Group

In addition to this, the ability of a pension scheme member to withdraw funds is very limited and the withdrawal is often discouraged by tax penalties. Tax penalties have been for instance introduced in the United Kingdom's reform in 2015.

Secondly, pension funds have limited short-term liquidity needs, which make them more inclined to buy and hold assets across the entire economic cycle. They also have an ability to behave counter-cyclical. In fact, the European Commission[5] itself acknowledged that pension funds did not experience the same problems as other financial institutions during the crisis: pension funds did not require any support in terms of funding from public finances.

Thirdly, pension funds do not employ significant leverage as they are legally limited in their borrowings. The low level of leverage ensures that a pension fund should not transmit significant financial stress to other counterparties.

Being low leveraged, risk averse and highly regulated long-term investors, pension funds do not pose a systemic risk to the financial markets.

Meanwhile and alarmingly, the ESRB argues in its report published on 19 July 2016 on "Macroprudential policy beyond banking: an ESRB strategy paper" that it is "likely that pension funds will make a relevant contribution to overall systemic risk" without backing this with evidence.

In its first European IORP Stress Test Report, EIOPA did not find evidence that IORPs pose systemic risk[6]. To the contrary they are able to mitigate financial shocks and work as a stabilising factor for the financial sector. As pension funds do not pose systemic risks, there is no need to include pension funds in the ESRB work.

(b) If deemed appropriate, what kind of systemic risks should be targeted and how?

PensionsEurope considers that market liquidity risks should be targeted. Please find below an explanation.

At the macroeconomic level, the most significant impact on workplace pension schemes is the impact of Quantitative Easing (QE) on defined benefit schemes, increasing their deficits and thereby increasing funding requirements.

Even though useful to strengthen economic recovery, the Quantitative Easing, as practiced by the European Central Bank, impacts liquidity in a significant way, especially in many areas of the fixed income markets but also other asset classes. The market making activities of banks and the usage of own trading books have historically been the foundation of a well-functioning fixed income market. With banks being absent and a central bank system creating high demand, the markets show a tendency to run dry of liquidity.

---

[5] See http://europa.eu/rapid/press-release_MEMO-09-99_en.htm

[6] On page 82 of EIOPA's IORPs Stress Test Report 2015, EIOPA concluded that *"The extent to which IORPs transmit the shocks to the rest of the financial sector and the real economy is limited".*

The impact of QE on pension funds needs further investigation. We point to EIOPA's Occupational Pensions Stakeholder Group paper[7] in this regard, in which it calls on EIOPA to conduct further research. We support the need for a better understanding of QE's positive and negative impact, taking into account European growth goals, supervision and financial stability goals.

Capital requirements for banks, imposed by Basel III and CRDIV rules, have had a negative impact on market liquidity, especially in the repo market. In fact, CRDIV and CRR restrict the liquidity on the repo market[8]. It is uncertain if these markets will remain open and liquid in times of stress when liquidity is needed the most[9].

We would like to refer to the "Global financial markets liquidity study" published by PricewaterhouseCoopers in August 2015. PwC' study "*highlights the importance of the role played by market makers in providing liquidity, which has diminished since the global financial crisis as the balance sheet capacity of market makers has fallen. This has led to reduced market depth. The implementation of further reforms is also likely to have significant implications for future market liquidity"* (see page 12). PwC identifies several ways in which regulatory reforms have impacted or will impact financial markets activity but banking regulation is placed on top, especially (see page 9):

- Bank deleveraging, refocusing and exits (leading to a reduction in served markets and streamlining of operations due to the new regulatory environment) and
- Reduction in market-making activity (especially in capital and funding intensive areas such as market making in fixed income, credit, derivatives and commodities leading to a reduction in liquidity in those dealer-led markets where market making provides a key source of liquidity).

Other problems with liquidity are:

- difficulties in executing trades (time taken and effort required to execute both with dealers and across multiple platforms has increased)
- reduction in market depth (falling transaction sizes; smaller trading volumes are now moving market pricing by larger amounts)
- increase in volatility (volatility in bond markets in 2015 was around 40% higher than in 2014 and volatility is arguably above historical levels during benign economic conditions)
- bifurcation in liquidity (liquidity is increasingly concentrating in the more liquid instruments and falling in less liquid assets; even traditionally liquid sovereign debt markets have experienced liquidity shortages)

[7] OPSG position paper on Quantitative Easing, 3 November 2015, available online: https://eiopa.europa.eu/about-eiopa/organisation/stakeholder-groups/opinions-feedback-from-the-eiopa-stakeholder-groups

[8] *The reduction in repo activity revealed by the latest survey was widely expected and is seen as reflecting subdued business conditions and the impact of leverage and liquidity regulations aimed at reducing the reliance of banks on short-term wholesale funding*". Page 4, International Capital Market Association, European repo market survey, number 28 conducted December 2014, published February 2015. http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/repo/latest/

[9] Baseline report on solutions for the posting of non-cash collateral to central counterparties by pension scheme arrangements: a report for the European Commission prepared by Europe Economics and Bourse Consult (referred to as the Europe Economics and Bourse Consult report in the following footnotes), p. 10.

II.3 Institutional setting

Question 29:

Do you think that the ESRB's mandate and tasks are appropriately formulated to ensure efficient coordination of macro-prudential policies in the EU?

Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all).

- ○ 1 (fully appropriate)
- ○ 2
- ○ 3
- ◉ 4
- ○ 5 (not appropriate at all)
- ○ Don’t know / no opinion / not relevant

If not deemed fully appropriate, what changes would you suggest to ensure such efficient coordination?

The structure and organization of the ESRB doesn’t ensure that it is an independent body.

To be able to fulfil the macro-prudential oversight of the financial system within the Union, the ESRB should not impose a bank-bias approach to other financial sectors. The independence of the ESRB should be strengthened by the provision of external resources instead of reliance on the ECB. The ESRB should also establish an independent Stakeholder Group.

From our perspective, it is important that the work of the ESRB is not a black box: input to the ESAs needs to be backed by evidence and it should be explained how it was derived. It should be possible to discuss any input from the ESRB to the ESAs both between EU institutions and among the relevant stakeholders, and these discussions should be taken into account by the ESRB.

We raise this point because of our experience with the IORP stress test 2015: The ESRB provided input to the technical specification around property prices to EIOPA which were far from reality and assumptions used elsewhere (e.g. for risk calculations under Solvency II): Under scenario 1 it was assumed that the value of property worldwide would fall by 46%, within the EU by 55% and outside of the EU by 44% (Scenario 2: world: - 62%; EU: - 36%; non-EU: - 67%). We suspect that these values were taken from the developments of Real Estate Investment Trusts (REITs), which display similar fluctuations to equity. However, REITS overall only play a negligible role in the portfolio of e.g. German IORPs, in contrast to traditional real estate investment. Because of these assumptions the resulting scenario did not provide any relevant insight, something which could have been corrected if they had been discussed before with the relevant EU institutions and stakeholders.

Question 31:

In particular, do you consider that the resources of the ESRB Secretariat are adequate in this context?

Please rank your answer from 1 (fully adequate) to 5 (not adequate).

- 1 (fully adequate)
- 2
- 3
- 4
- 5 (not adequate)
- Don’t know / no opinion / not relevant

Please, explain your scoring:

The ESRB should have its own resources instead of relying on the ECB resources.

Question 32:

What do you consider to be the best ways to ensure that the macro-prudential perspective is sufficiently reflected in EU policymaking where systemic risk considerations are involved?

More coordination is needed, also at the international level. However, PensionsEurope urges to refrain from implementing measures beyond banking without evidence of systemic risk.

Question 33:

How do you assess the instruments and powers of the ESRB? In particular, do you see the need for the ESRB's powers to explicitly include 'soft power' tools with a view to fulfil its mandate?

Currently the instruments and powers of the ESRB are calibrated to address the banking industry – and rightly so. Since from our perspective pension funds are not posing any systemic risks, as a pension fund organisation we are therefore not in a position to respond to this and the following questions.