PENSIOEN FEDERATIE

3 December 2019

Pensions and the Next CMU

Harnessing the long-term investment potential of pension savings

The Capital Markets Union is an ambitious long-term project that aims to improve access to capital for businesses of all sizes, support the transition to a more sustainable economy and make both the eurozone and financial system more resilient to shocks through the integration of capital markets.

With the new European Commission freshly installed, we call upon the EU to reinvigorate the project and set an ambitious new agenda for the next five years. We are convinced that Europe's pension funds play a vital role in delivering these goals. **We therefore urge the European Institutions to build on the work done by the Next CMU High-Level Expert Group**[1]. We would like to draw attention to three recommendations in particular that would harness the long-term and cross-border investment potential of pension savings:

1. Introduce a multi-pillar adequacy test for pension systems
2. Address barriers to cross-border investments
3. Complete the European framework for sustainable investments

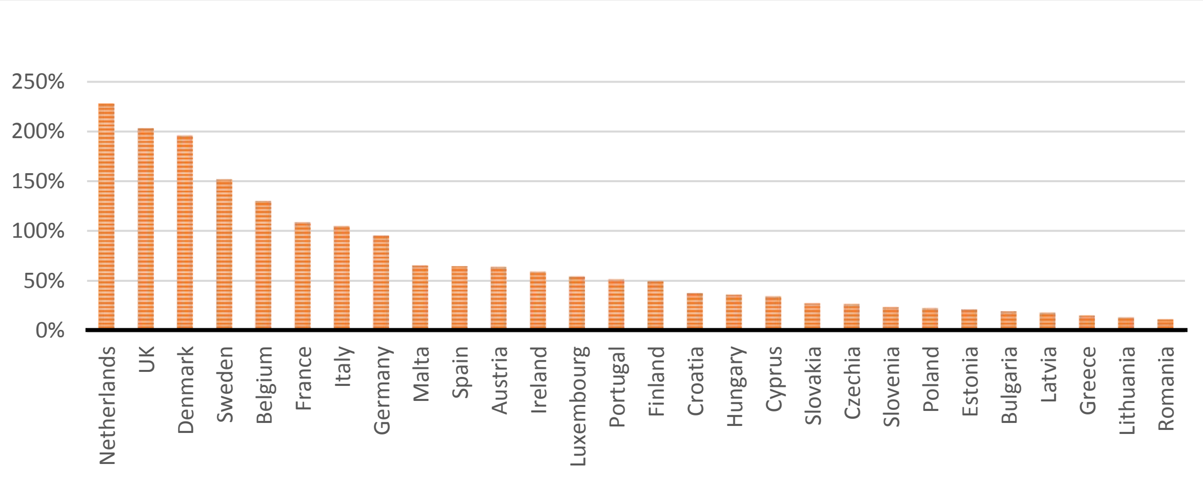
Why pension funds matter for the Capital Markets Union

Pension funds invest the money that is entrusted to them with a time horizon that often spans decades. They are able to build **diversified long-term portfolios**, with the majority of contributions being allocated to public equity and bonds. Pension funds therefore are important shareholders of quoted companies and provide debt funding for capital investments of corporates. As professional investors that benefit from economies of scale, they are also able to invest in parts of the market often unavailable to retail investors. For example, many pension funds support SMEs and private companies through private equity investments and securitisation. Finally, many funds will also invest directly in real estate and infrastructure.

Households in countries with strong second and third pillar funded pension systems therefore invest, through pension funds and other providers, significantly more in capital markets than countries with pay-as-you-go systems. Notably, countries with (quasi)-mandatory occupational pension systems top the list of countries where households hold most assets in capital markets. Developing strong multi-pillar pension systems would therefore not only improve the sustainability and adequacy of pensions, but also **deepen cross-border capital markets**.

[1] Please find the report at https://www.nextcmu.eu/.

Figure: household market financial assets as % of GDP[2]



Recommendation 1: Introduce a multi-pillar adequacy test for pension systems

The Next CMU group rightly recognizes that the design of pension systems is and should remain a national competence. What constitutes an 'adequate' pension, and which vehicles are to save, should not be decided by the EU. Instead the Group calls for a **multi-pillar adequacy test** as part of the European semester, under which Member States should set their own long-term targets for improving pension adequacy. The Structural Reform Support Service should help countries with implementing the reforms necessary to achieve these targets and the Social Protection Committee would be tasked with benchmarking progress. We feel this to be the right approach that will both help citizens to save for better pensions and advance the CMU, while respecting Member State sovereignty.

Recommendation 2: Address barriers to cross-border investments

Dutch pension funds have the smallest home bias in the EU, with 87% of assets invested outside the Netherlands, of which a very significant share within the EU[3]. Nevertheless, there remain challenges for investing cross-border that the EU should tackle. First, this means to address **inadequate withholding tax regimes**. Procedures for repayment are cumbersome, slow, costly and sometimes unpredictable. The patchwork of procedures and outcomes inhibits intra-EU investments, particularly for smaller schemes. The European Commission has tried to tackle the problem, but we believe a harmonized European procedure is needed to overcome these challenges. Member States can also take action unilaterally, should they want to improve the conditions for inward investments.

Second, **modernising Member States' insolvency regimes** could increase faith in investors' ability to retrieve any residual value of cross-border investments in firms that fail. Insolvency

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[2] Financial assets include listed equity, bonds, assets in pension funds and life insurance, mutual funds. AFME 2019, source.

[3] OECD 2019, Pension Markets in Focus, Source.

procedures are currently lengthy and the diversity of regimes means that investors can be hesitant to commit to higher risk foreign investments, as they struggle to assess the implications of insolvency. The EU has recently adopted initiatives in this area, but we underline the importance of the recommendations in the Next CMU rapport to continue progress in this area.

Recommendation 3: Complete the European framework for sustainable investments

Pension funds have liabilities that stretch until the end of the century. They therefore consider relevant long-term risks, including sustainability risks, in their investment decisions. Simultaneously, pension funds increasingly look at how their investments are aligned with the values of beneficiaries or clients. The EU's action plan on sustainable finance has delivered a first set of useful initiatives, but institutional investors continue to face data challenges to measure and compare sustainable investments. In particular, they **need adequate non-financial corporate reporting** in order to incorporate sustainability risks and factors in investment decisions, to make meaningful disclosures themselves and to be able to apply the taxonomy reliably. The Commission should also **stimulate an adequate supply of suitable 'green' investment opportunities**, amongst others by stepping up its InvestEU programme, while ensuring public support meets strict additionality criteria.

On behalf of 197 pension funds, the Federation of the Dutch Pension Funds (Pensioenfederatie) promotes the pension interests of 5.8 million participants, 3.4 million pensioners and 10 deferred participants. About 85% of Dutch employees is participant of a pension fund which is associated with the Pensioenfederatie. The members of the Federation have around 1500 billion euros of assets under management.

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