29 May 2015

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PensionsEurope's response to FSB/IOSCO consultation on NBNI G-SIFIs

PensionsEurope welcomes the opportunity to reply to the "consultation on the Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions - Proposed High-Level Framework and Specific Methodologies", published on 4 March 2015 by the Financial Stability Board ("FSB") and the International Organization of Securities Commissions ("IOSCO").

Q2-1. In your view, is the exclusion of (i) public financial institutions, (ii) sovereign wealth funds or (iii) pension funds from the definition of NBNI financial entities appropriate? If so, please explain the rationale.

The members of PensionsEurope agree with the FBS and IOSCO rationale that pension funds should be excluded from the scope of the NBNI G-SIFI methodologies. Indeed, we agree that due to their long-term investment perspective, pension funds pose low risk to global financial stability. Below we provide our arguments showing that the exclusion of pension funds from the scope is appropriate.

Pension funds are first and foremost institutions with a social purpose. They are to a large extent responsible for occupational retirement provision and have become an indispensable addition to public pensions systems. They are strongly embedded within national social models and primarily governed by social and labour law. The regulatory framework requires that pension funds are transparent, low leveraged and diversified with prudence.

First of all, one of the reasons to exclude pension funds from the NBNI G-SIFIs is that the probability that a pension fund fails is very low. The failure of these institutions is rare, because they use derivatives only to hedge currency and interest rate risks related to the fixed-income investments, and not to speculate. Similarly, they can use swaps solely to manage risk.

Moreover, 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.

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. According to the Bank of England pension funds 'may also be less subject to pressure to respond to short-term market movements, or they may be more willing and able to take advantage of market movements by buying assets at the bottom of the cycle and selling at the top. As such, they might have the potential to play a stabilising, or even countercyclical role in the financial system.' This has been proved during the last financial crisis. In fact, the European Commission 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 and consequently they should be excluded from the scope of NBNI G-SIFIs. Pension plans sponsors managing assets in-house should be also excluded from the scope of the methodologies as they act solely in the interest of the pension plan.

1. **Q2-2. Please explain any potential systemic risks associated with failure or financial distress of (i) public financial institutions, (ii) sovereign wealth funds or (iii) pension funds that, in your view, warrant their inclusion in the definition of NBNI financial entities so that NBNI G-SIFI methodologies would apply**

As explained under Q2-1, the risks associated with failure or financial distress of pension funds are very low.