Response to call for evidence regarding the EU regulatory framework for Financial Services

Well-functioning EU single market needs balanced EU financial regulation

On 30 September 2015 European Commissioner Hill presented an Action Plan for Building a Capital Markets Union. For PGGM as a pension investor and PFZW as a pension fund, the benefits of a well-functioning European Single market which contributes to sustainable economic growth are plenty and paramount. For the latter, a balanced and well-designed set of EU financial regulations is crucial.

PGGM and PFZW would like to actively contribute to this discussion and our viewpoints are listed in our contribution to the call for evidence regarding the EU regulatory framework for Financial Services. This document highlights our main topics, concerns and remedies where possible.

Main concerns and highlights of our Call for Evidence response

PGGM and PFZW would like to actively contribute to this discussion. As pension fund and dedicated service provider, PFZW and PGGM hold a strong interest in the regulation and supervisory role of the EU in its financial markets. The past years the role of regulators and supervisors has increased significantly. This was for good reasons. Striving for transparency in, standardisation of markets and products is helpful and designing and implementing safe market environment like central clearing of derivatives. So is regulating conduct of market players. Nonetheless, some serious implications of this regulatory work have not yet been properly identified and tackled. Some new regulation has negative impact which can be categorized as unintended consequences.

The Call for Evidence launched by the European Commission provides a platform where we would like to address our interests and concerns, in the general interests of the pension fund's participants.

Pensioenfonds Zorg & Welzijn

PGGM Voor een waardevolle toekomst

1. Cash variation margin requirements under EMIR and CRDIV

EMIR pushes towards central clearing of derivative transactions. One of the main consequences of central clearing is the requirement of Central Counterparties (CCP's) to post cash as variation margin. While we support voluntary central clearing for pension funds and have demonstrated this by investing heavily in preparing for clearing, one of the fundamental issues for pension funds in relation to central clearing remains the impact to post variation margin in cash. Pension funds typically minimise their allocation to cash in order to maximize the efficiency and the return for the pensioners. Requiring such entities to centrally clear OTC derivatives contracts would lead to divesting a significant proportion of their assets for cash in order for them to meet the margin requirements of CCPs.

We encourage the development of a robust solution to the cash variation margin issue that pension funds can rely upon in all market conditions including stressed market conditions, and without introducing any material adverse effect on pensioners, rather than a permanent exemption for pension funds from central clearing. We recognise the importance of pension funds being able to use centrally cleared derivatives in the new regime post regulatory reform, and therefore we believe it is paramount that a central clearing solution is developed that also works for pension funds. We seek a solution that would allow European pension funds to use non-cash variation margin such as high quality government bonds. This can either be achieved through a robust collateral transformation service or by direct acceptance of non-cash variation margin by clearing houses. It is critical for any solution to work (a) in stressed market conditions and (b) without a material adverse effect on pensioners (including disproportionate risk or cost), before mandatory central clearing is applied to pension funds.

No robust central clearing solution has yet been developed for pension funds that can be relied upon in stressed market conditions. We request the engagement of policymakers and other stakeholders to ensure that any solution that is developed is robust and can be relied upon even in stressed market conditions.

However, the issue of posting cash as a variation margins is already seen in OTC derivative markets due to capital rules imposed by Basel III/CRDIV on banks. The leverage ratio and NSFR rules only allow cash variation margin to offset any positive mark-to-market exposures borne by a bank on OTC derivatives positions. Non-cash variation margin, even high quality government bonds, are not permitted to offset the mark-to-market exposures. Many banks are now restricting OTC derivatives trades to those that are collateralised with cash variation margin only, where previously banks would also accept high-quality government bonds as variation margin.

We suggest policymakers to consider allowing high-quality government bonds with appropriate haircuts to offset the Mark-to-market exposures of OTC derivatives in leverage ratio and NSFR calculations.

2. Synthetic risk-sharing securitisations are fit for STS securitisation regulation

Synthetic securitisations that meet certain criteria are good for the economy, conceptually simple and appropriate for standardization. From a financial stability perspective, they are often preferable to cash securitisations as they can help transfer risks off the bank's balance sheet and share these with investors outside the banking sector.

As such, we strongly encourage the inclusion of synthetic securitisation in the proposed regulatory framework of Simple, Transparent and Standardised ('STS') securitisations.

Securitisation transactions are a valuable asset in a diversified long-term investment portfolio. PGGM engages only in synthetic securitisations, in which a strong alignment of interest between banks and investors is key. This ensures that banks continue to monitor and service these loans in accordance with their internal best practices, even after some of the risks have been shared with investors.

The European Banking Authority ('EBA'), at the request of the European Commission, conducted a study regarding inclusion of synthetic securitisations in the STS framework. In its report of December 2015, the EBA recognises the added value of synthetics within the securitisation landscape and sets out its first ideas how to include these in the current legislative proposal. We welcome and support this recognition. In this Call for Evidence, we present our main feedback on the EBA report.

3. Pre- and post-trade transparency is potentially disruptive

While PGGM and PFZW strongly support the need for more transparency in financial markets, we have difficulties with some of the aspects of pre and post trade transparency. Pre-trade and post trade transparency is potentially disruptive to OTC markets, may decrease market making, increase volatility and increase trading costs to institutional investors. These elements will lead to a lower and less predictable pension outcome for our clients. PGGM takes great care in not disturbing the markets while managing its positions and executing trades for its clients. This is possible because some mutations in the positions are not advertised to the markets.

Post trade transparency would increase potential front running which result in higher costs.

PGGM and PFZW support post-trade transparency shortly after a trade to prevent market disruptive behaviour of market participants and avoid market price distortion and would welcome a distinction between pre trade and post trade transparency to the market and pre trade and post trade transparency to regulators.

4. Harmonisation of tax rules is needed

A gap exists in the area of claiming tax benefits, granted by a certain EU Member State to pension funds resident in that EU Member State (and/or resident in another EU Member State), by a pension fund that is resident in another EU Member State, on the basis of the prohibition of any discrimination on the ground of nationality.

PGGM proposes the EU considering to implement a harmonised definition of 'pension fund' within the context of claiming tax benefits, granted by a certain EU Member State to pension funds resident in that EU Member State (and/or resident in another EU Member State), by a pension fund that is resident in another EU Member State, on the basis of the prohibition of any discrimination on the ground of nationality.

In our view, a harmonised definition of 'pension fund' in this context will significantly contribute to removing undesirable and unnecessary obstacles for pension funds when investing in other EU Member States and accordingly claiming domestic tax benefits applying to pension funds across other EU Member States.

Such harmonisation should prevent from tax evasion behaviour and assist in collecting all tax unpaid tax claims and consequently should (i) enhance the single market for all 28 Member States and (ii) contribute to a higher level of investor protection.

5. Algorithmic trading is becoming mainstream. Clear distinction between HFT and algorithmic trading is needed.

Pushing markets towards more transparency, control and supervision will increase automation. Automation of transactions helps the financial industry to become more transparent and effective. This will result in a situation where trading is heading for an automated algorithmic environment. Rules regarding algorithm trading were drafted years ago and are focused on high frequency trading (HFT). However, it is important to make a clear distinction between high frequency trading and algorithmic trading markets. Algorithmic trading and high frequency trading in itself is not harmful and is generally used by many market participants, the technology should not in our view be subject to restrictions.

The way in which algorithmic trading and high frequency trading is used should be regulated and subject to monitoring as it is the behaviour of players in the market that creates the problem.

PFZW is responsible for the pension policy and pension assets of 2.5 million current and former employees in the Dutch care and welfare sector. The pension fund manages invested assets which amount to €163.6 billion at the end of December 2015. PFZW has outsourced the administration of the pension scheme and the management of the pension assets to PGGM.

PGGM is a cooperative Dutch pension fund service provider. Institutional clients are offered: asset management, pension fund management, policy advice and management support. On December 31, 2015 PGGM had € 183.3 billion in assets under management. The PGGM cooperative has approximately 700,000 members and is helping them to realize a valuable future. Either alone or together with strategic partners, PGGM develops future solutions by linking together pension, care, housing and work.

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PENSIOENFONDS ZORG & WELZIJN

PGGM
Voor een waardevolle toekomst

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