LSEG Position Paper on the Pan European Personal Pension

Introduction

- **LSEG welcomes the European Commission's proposed Pan European Personal Pension (PEPP).** This is a positively forward looking initiative which clearly indicates that the post crisis policy agenda has pivoted towards an enabling viewpoint with the potential to unlock Europe's capital markets to tackle long term economic challenges, as part of Capital Markets Union (CMU). These include the ageing population and the need to transition to a more sustainable economy. We welcome the support of the European Parliament, who have a key role to play in delivering more of an investment culture amongst EU citizens, which is key to move towards a more entrepreneurial and risk taking society required to support capital markets development and reorientate away from an overreliance on bank financing. In turn this diversification will support innovation, growth and buffer against financial instability. *However we believe that action is required to ensure that contribution that PEPP can make to these CMU objectives are maximised and also to avoid unintended consequences on existing pension provision*.

- **This briefing is divided into three sections:** First, an explanation of why maximising the CMU objectives of the PEPP are important; second a description of those PEPP element which help to deliver CMU objective and last, LSEG's recommended enhancements to optimise the positive impacts for CMU.

<u>Summary of Key Points</u>

Capital Markets Capacity	Pension fund size supports capital market depth and this supports growth - matching the US scale would boost Eurozone market capitalisation by 31%
Investment Culture	Giving citizens a stake in the growth of capital markets will support more an investment culture (like 401k did in the US).
Existing Pensions Provision	There is significant pension fund potential in the EU and this needs to be supported. The European pension market is the second largest in the world.
Role of Market Infrastructure	International liquidity pools; investor education; direct financing platforms; SME funding channels; sustainable finance hubs and fund accessibility
Investment Rules	We support the prudent person rule however greater flexibility should be allowed.
Supervision	A level playing field is required to encourage maximum PEPP provision
Proportionality	Guarantees, fee caps and other compulsory features should be reconsidered
CMU Framework	Solvency II and the Prudential Regime for Investment Firms should support more market liquidity and equity investments.
Supporting Global Asset Managers	The industry is needed to make PEPP a success so it shouldn't be hit with unwelcome changes to delegation under UCITS
Role of Member States	Appropriate tax incentives and behavioural tools are needed

1. Why maximising the Capital Markets Union objectives of the PEPP are important

- **Capital Markets Capacity.** Ensuring retirement income adequacy is a very important objective which the PEPP has a role to play in achieving (particularly for young people and in countries where the pensions systems is less developed e.g. CEE); however the goal of using PEPP to boost capital markets capacity should not be underestimated. There is a significant positive relationship between the size of occupational or personal pension plans and capital market depth (as measured by the ratio of the market capitalisation of outstanding domestic stocks and outstanding domestic stocks and bonds to GDP). By increasing pension assets in the euro area and the EU by respectively 73% and 60% of GDP (i.e. to the levels observed in the US around 90% of GDP), this would generate an additional stock market capitalisation of 31% and 26% in the euro area and EU respectively[1]. This is important because, consistent with the objectives of CMU, research shows that an increase in stock market capitalisation by 10% of GDP boosts GDP growth by 0.21% whereas an increase in intermediated credit by 10% of GDP has been associated with a 0.33% reduction of GDP growth.[2]

- **Investment Culture.** Giving citizens a stake in the growth of capital markets will support more an investment culture (like 401k did in the US and is already the case where pension systems are more developed e.g. UK/NL). We note that EU consumer representative groups have argued that the PEPP should empower citizens to take more of an informed and active role in how their money is invested, on a transparent basis, in order to avoid the loss of funds due to information asymmetries and charges.

- **Existing Pension Provision**. There is significant pension fund potential in the EU and this needs to be supported. The European pension market is the second largest in the world. Combined assets under management totalled €6.16 trillion for the top 1000 pension funds[3]. Total pension fund assets (as per OECD definition) in the EU are at around 30% of GDP compared to 79% in the United States.[4] This is therefore a tremendous opportunity which the PEPP has a key role to play in grasping. Therefore it needs to be done in a way which supports capital market participants (i.e. to create an attractive market for PEPP providers and distributors and allow diverse asset allocation including to equities and SMEs.) Other benefits to supporting existing pension providers include financial innovation, corporate governance standards, and increased demand for market infrastructure modernisation such as the trend towards more direct investments and co-investment platforms (see box below).

The Role of Market Infrastructure in supporting pension funds: *innovative and efficient channelling of pension savings into real economy investments*

- **International Liquidity Pools**: Domestic institutional investors are key to support the development of local capital markets because they provide local knowledge and proximity (especially key for SMEs) and this is optimised when there is also a diversity of international investors present (e.g. both Borsa Italiana and LSE markets have a shareholder base with more than 50% of market cap held by foreign investors).

- **Investor Education.** Examples include regular involvement of Italian Asset Owners in 'ExtraMOTPro Project', via free access to mini bond market information; a partnership with ANIA (Italian Insurance

[1] EFSIR 2016
[2] OECD, Cournède, B. and O. Denk (2015), "Finance and Economic Growth in OECD and G20 Countries",
[3] CMU Staff Working Document, European Commission
[4] Impact Assessment accompanying the PEPP proposal

Companies Association) to create cross-fertilization opportunities between investors and SMEs and a recently launched of Observatory of Italian Asset Owners investing in Italian Real Economy, to create capacity building by mapping and valuing best case studies.

- **Direct Financing Platforms.** Pension funds are significantly increasing direct investments, demanding such opportunities both to cut costs and to gain investment experience. Examples include the €122 million ELITE Basket Bond (December 2017). The ten-year securitised bond is made up of ten well performing and innovative Italian SMEs with European Investment Bank (EIB) and Cassa Depositi e Prestiti (CDP) being the lead investors alongside a direct investment from asset owners.

- **SME Funding Channels.** SME Growth Markets such as AIM / AIM Italia are a growing way to fund innovative and fast growing SMEs. AIM has helped over 3700 companies raise over £106bn of capital since its creation in 1995 whilst AIM Italia currently has 95 issuers with total capital raised since inception in 2008 at €2.3 bn. On top this new programmes like ELITE, launched by Borsa Italiana in 2012, aims to help growth companies navigate the funding ladder with an innovative approach, including a training programme, and direct access to the financial community through dedicated digital community facilities.

- **Sustainable Finance Hubs.** At London Stock Exchange, as a UN Sustainable Stock Exchange, we have dedicated green bond segments with 64 Green Bonds, raising $20.1 billion in 7 different currencies. We saw a doubling in the number of bonds issued in 2017 compared to 2016. FTSE Russell has created over 80 ESG Indices. LSEG has also launched guidance to issuers for ESG communication and dialogue with investors and organized sustainability day, with education sessions and more than 100 one-to-one meetings among institutional investors and listed companies around long term sustainability topics.

- **Fund Accessibility.** LSEG offers a choice of 450+ closed ended funds with a combined value of €221bn across asset classes, structures and mandates (SMEs, sustainable, infrastructure etc.).

2. Elements of the PEPP which help to deliver CMU objectives

“There is not enough investment by insurance companies and pension funds in risk capital, equity and infrastructure.”

“Retail investors' participation in the [SME] market, for instance through the allocation of part of their pension fund investments, would deepen the market and provide a strong impetus for its development. “

(European Commission, Capital Markets Union Mid Term Review)

- **Investment Rules.** We welcome that all assets classes are open to investment, including unlisted products such as SME Growth Market securities, and other less liquid assets suitable for long term holdings (as indicated in recitals 34-35) and there are no unnecessary restrictions. We support the ‘prudent person’ principle (consistent with IORP and Solvency II) and would be opposed to the introduction of any undue quantitative thresholds or restrictions. However it is not quite clear whether the regulated market investment that are predominately required can be made indirectly through unlisted funds (in some cases specialist funds that invest in SMEs are added to trading on MTFs no regulated market and are not listed). We believe that there should be flexibility and choice available for members of PEPP schemes in order to accommodate many different types of savers (different risk appetites, incomes, needs etc.). For many PEPP savers, where there is limited choice in their member state of residence, the default option would be appropriate however the product should be flexible also to welcome other citizens who wish greater choice over how the investments are made.

- **Complementarity.** We support that the European Commission's objective is for the PEPP to be complementary to existing occupational and workplace provision rather than undermine it. This is a welcome aim because it will help to create new markets and opportunities for capital markets participants, given that PEPP will open up a market of access to more than 240m retirement savers across the EU[5] which is estimated to double to €2.1tn over the next decade. The PEPP should promote competition (e.g. through the switching option), and allow providers to reach a potentially greater scale by removing cross border barriers to distribution (portability), at the same time as protecting the excellence provision that already exists in some parts of the EU. However pension provision is very uneven across the Single Market and therefore extreme care must be taken to ensure that PEPP helps to improve access to pensions in those member states where it is lacking but it remains sufficiently flexible in its requirements not to have any unintended consequences for existing providers.

- **Simplicity**. The aim to create a simple product with standard features and the ability to passport across Europe will support the ability to deliver economies of scale and therefore make the product cost efficient from a consumer point of view. It should also make the product a more attractive one for providers to enter. We also welcome the aspiration to have clear and regular benefit statements because this will help citizens understand the value of their investments. In this respect we find the idea proposed by the European Parliament Rapporteur of a 'Union pension tracker' (Amendment 17) a useful one worth exploring because this may help consumers to overcome the well known aversion to long term investment contributions due to the receipt of benefit being so far in the future.

- **ESG requirements**. We agree with the European Commission that the PEPP is another tool that can be used to support the transition to more sustainable investment. This is especially important given the evolving nature of fiduciary duty and the wish of citizens to direct their savings not just to provide for adequate retirement income but also to help shape the future of world to take account of more sustainable factors.

3. LSEG recommendations to maximise the positive impact of PEPP on CMU objectives

- **Supervision.** In order to ensure that providers are encouraged, we believe policymakers should be mindful over the concerns over regulatory arbitrage and the impact on existing providers given that there will be different regulatory frameworks for different potential PEPP providers. For example, different prudential requirements; sectorial requirements on asset allocations (Art 33.2). We share concerns over the role of EIOPA in authorising PEPPs, rather than NCAs who are closer to market participants and understand the specific requirements of consumers in each member state. There may otherwise be unduly complex procedures which would inevitably involve duplication of tasks between EIOPA and NCAs. We also urge that policymakers recognise the role of intermediaries in providing value to PEPP distribution in particular and growing capital markets capacity in general. The whole value chain is important to the success of capital markets. Brokers and distribution agents are a vital

[5] FT

piece of the capital markets ecosystem and they require a clear and level playing field in terms of distribution requirements. However as drafted providers could face different rules depending on whether they are regulated under the Insurance Distribution Directive (IDD) or MiFID (e.g. there may be a differential interpretation of the inducement requirements).

- **Proportionality**. In general, to encourage the greatest level of appetite to both provide and contribute to a PEPP we believe that proportionality in the requirements is key. For example, we share concerns that the requirements to provide a guarantee, and fee caps, may deter providers due to the cost involved (of up to 1% of the contributions[6], which may not either be in the interests of the consumer, especially given this is pillar III and the free choice of the consumer and there may also be tax implication for guarantees). The requirement for a national compartment in all member states after a transition period may also be unduly burdensome for market entrants. Investment choices should offer more flexibility, switching ought to be allowed more often than every five years and on information requirements we urge policymakers not to repeat the mistakes of the PRIIPs KIID approach, which can give misleading information whilst hampering the choice of securities on the market. Finally, given that the risk mitigation requirements are a level 2 measure to be proposed by the Commission, industry is unlikely to have clarity over these aspects for some time and this may hinder the interest of providers.

- **CMU Regulatory Framework**. Other parts of CMU regulation should be calibrated to be consistent with the same goals of market liquidity, efficiency choice and lower costs if the PEPP is to maximise its positive impact on developing European capital markets. For example, a rebalancing of the Solvency II rules on equity investments when the review takes place (to reduce overweighting in sovereign bonds) and ensuring that the current proposal on prudential requirements for investment firms take account of the lower risk profile of principal traders acting as market maker providing crucial liquidity to long only pension funds and asset managers, which is particularly important in times of stress (bank like risk measures are not appropriate.) We agree with the European Commission that “over the past 15 years EU insurance companies have reduced their equity investments to around 5-10 % of their current total portfolio [and] There is a need to assess the economic drivers of equity investments by insurance companies and pension funds, including investments within the EU and the potential impact of regulatory constraints at EU and national level and other factors.”[7]. We look forward to the assessment of the drivers of equity investments by insurance companies & pension funds due in Q4 2018.

- **Supporting Global Asset Managers.** Policymakers need to consider further how to support the global; asset management industry who ultimately are needed to make PEPP a success. We believe that a third country regime should be introduced for PEPPs and more importantly the ESA review proposals surrounding the outsourcing and delegation of portfolio management are counter productive, because global asset managers are needed to deliver PEPP therefore regulation needs to work in a global context. Outsourcing and delegation arrangements are an important mechanism for the provision of financial services to clients, including offering cost-effective services while allowing greater access to international finance and investment strategies. We believe the ESA review proposals are too burdensome (e.g. reporting to ESAs on regular outsourcing by NCAs) and could impact these benefits. There is no evidence that the current arrangements do not work well today. On the contrary, they support UCITS as a global brand, distributed in 75 countries with nearly half AuM denominated in currencies other than the Euro. The aspiration should also be for PEPP to be a global brand.

[6] OECD Pensions Outlook 2012
[7] European Commission CMU Mid Term Review

- **Member States.** Finally we agree that member states have a key role to play in ensuring that PEPPs can have equal access to appropriate fiscal incentives that encourage saving without undermining the fiscal position of existing pension providers. In addition other types of fiscal incentives have a role to play in channelling funds into real economy investments (e.g. the PIR tax relief in Italy). Furthermore they should consider behavioural mechanisms to ensure greater participation and higher contributions (such as automatic enrolment as introduced in the UK).

Conclusion

- **We believe that the PEPP is a great opportunity to boost capital markets union and hence the real economy**. The way to achieve this is to ensure it complements existing pension providers and capital markets participants Therefore it should be flexible in design and be supported by other relevant regulatory adjustments to complement this, all market participants have a role to play in ensuring that the PEPP delivers its objectives, including market infrastructure, asset mangers, infrastructure, and intermediaries.

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1) Capital formation – operation of a range of regulated markets and MTFs across asset classes including London Stock Exchange and Borsa Italiana, AIM / AIM Italia the SME Growth Markets as well as Turquoise (pan European equity trading venue) and MTS (pan-European Sovereign bond venue). Through its platforms, LSEG offers market participants, including retail investors, institutions and SMEs unrivalled access to Europe's capital markets. The Group also plays a vital economic and social role, enabling companies to access funds for growth and development.

2) Intellectual property – Through FTSE Russell, the Group is a global leader in financial indexing, benchmarking and analytic services with approximately $15 trillion benchmarked to its indexes. The Group also provides customers with an extensive range of data services, research and analytics through Mergent, SEDOL, UnaVista, XTF and RNS.

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