NAPF

Securing the future of pensions

EC Green Paper

Building a Capital Markets Union: a response by the National Association of Pension Funds

May 2015

www.napf.co.uk

Contents

Executive Summary

- The NAPF strongly supports the European Commission's vision of a Capital Markets Union (CMU). Pension funds – and their members - have much to gain from a CMU that makes it easier to invest for the long term and across borders.

- Pension funds are – together with banks, fund managers and insurance companies – the EU's key institutional investors and providers of capital. The NAPF's members have more than €1.1 trillion of assets invested across the global economy – including at least €400 billion across Europe. And, of course, much of the insurers long-term investment is drawn from pension funds.

- It is essential that policies to develop the Capital Markets Union are seen through the prism of long-term institutional investors such as pension funds. Policy-makers should ensure that investment opportunities provided by governments or the EC offer the kind of risks and returns required by pension funds as they look to meet their liabilities to pay pensions.

- Pension funds need a stable long-term investment environment. Political risk (i.e. the risk of changes in policy which affect investments) can discourage long-term investments in the real economy, such as in infrastructure.

- On infrastructure specifically, national governments and the EU institutions should ensure there is a clear and well understood 'pipeline' of future investment opportunities.

- EC policy-makers should ensure that all aspects of EU policy – and all EU institutions - are aligned with policy on the CMU. There is a particular concern that the 'Holistic Balance Sheet', currently being developed by EIOPA, would force pension funds to move even further into low-risk asset classes such as government bonds – at the expense of investment in equities and other growth-generating assets.

About the NAPF and its members

The National Association of Pension Funds is the voice of workplace pensions in the UK. We speak for over 1,300 pension schemes that provide pensions for over 17 million people and have more than €1.1 trillion of assets. We also have 400 members from businesses supporting the pensions sector.

We aim to help everyone get more out of their retirement savings. To do this we spread best practice among our members, challenge regulation where it adds more cost than benefit and promote policies that add value for savers.

The NAPF is a member of PensionsEurope, which is currently chaired by the NAPF's Chief Executive, Joanne Segars.

The NAPF's members are major investors in the EU economy. Approximately 13.6% of our defined benefit members' assets are invested in European equities (9.4% in the UK and 4.2% elsewhere in Europe)[1], with further allocations to UK Government bonds (20.6%) and Eurozone sovereign bonds (0.6%).

These figures alone amount to an investment of nearly €400 billion in the European economy (€150 billion of which is in equities) and our members make further contributions to EU economic growth through their allocations to other asset classes such as property, infrastructure, private equity and venture capital.

The Pensions Infrastructure Platform (PiP)

The NAPF has made its own innovative contribution to promoting long-term investment by establishing – following discussions with the UK Government and Pension Protection Fund – a Pensions Infrastructure Platform (PiP).[2]

The PiP is an infrastructure investment adviser set up to encourage and facilitate UK pension scheme investment into UK infrastructure. The PiP has been created by pension funds, for pension funds to give schemes of all sizes access to long-term, low-risk infrastructure investment opportunities.

The PiP has used the combined buying power of the Founding Investors to obtain suitable management expertise at attractive fee rates. Once an initial close for Founding Investors has been achieved, the investment opportunity is then offered to other UK pension schemes and institutional investors.

To date PiP has invested €347m in UK infrastructure assets. It serves as a model for bringing institutional investors into new areas of investment on terms that work in their favour.

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[1] NAPF *Annual Survey 2014*, p.41

[2] Further details about the Pensions Infrastructure Platform are available on www.pipfunds.co.uk

- *PiP Limited is owned by the NAPF.* It was established with the aim of developing a range of infrastructure investment opportunities structured for pension funds, by pension funds. Its development has been funded by loans from PPF and nine UK pension funds (the Founding Investors).

- *PiP is not a government entity.* The UK Government does not and will not direct how it invests. PiP invests in a way that is suitable for pension funds and investment opportunities are developed to meet their needs.

- *PiP is already investing.* In October 2013, agreement was reached to proceed with a PPP Equity fund and Dalmore Capital was selected to raise, manage and operate the Fund. A first close of the Fund in February 2014 raised £260m (€351m) from five of the Founding Investors in PiP. Further closes have subsequently been held and the Fund has raised over £500m of its £600m target.

- *Looking to the future.* PiP has launched a rooftop solar PV fund managed by Aviva Investors and is developing an internally managed multi-strategy infrastructure fund for launch later this year.

Answers to questions in the Green Paper

1. Beyond the five priority areas identified for short term action, what other areas should be prioritised?

- The NAPF has no further priorities to add, but we are concerned to ensure that the policies developed in support of the fourth priority (boosting long-term investment) are seen through the prism of long-term institutional investors such as pension funds.

- This means that national governments and the EU institutions should ensure there is a clear and well understood 'pipeline' of future investment opportunities.

- Policy-makers should also ensure that investment opportunities provided by governments or the EC offer the kind of risks and returns required by pension funds as they look to meet their liabilities to pay pensions. Policy-makers should also recognise that daily pricing of infrastructure investments can be challenging

- In formulating policies intended to attract more long-term institutional investment into the EU economy, policy-makers should bear in mind that the investment needs of

defined benefit and defined contribution pension schemes can be quite different and they invest in different ways.

- DB schemes pool investments across the entire membership and – particularly in the case of larger DB schemes - are able to use bespoke investments designed to match the individual scheme's particular liabilities.

- DC schemes, by contrast, tend to use 'off the shelf' collective investment funds, so do not make individual decisions on the underlying assets; these decisions are taken by fund managers.

- DB schemes are relatively mature institutions, with large proportions of retired or deferred members.[3] This means their key investment concern is to match liabilities, driving them towards low-risk investments weighted towards bonds and other fixed-income instruments.

- DC schemes, however, are relatively immature institutions, with large numbers of active members currently working and saving for their retirement. This means that DC schemes focus their investment on risk-seeking, return-generating asset classes, such as equities.

- Auto-enrolment and the shift from DB to DC provision are set to increase the scale of DC saving quite sharply, and it remains to be seen how this will affect the nature of DC investment in the future.[4] It is possible that increasing scale will enable DC schemes to increase their allocations to more illiquid and less standardised assets. However, the charge cap on DC schemes used for auto-enrolment in the UK may act as a brake on diversification of asset classes.

- EC policy-makers should ensure that all aspects of EU policy – and all EU institutions - are aligned with policy on the CMU. There is a particular concern that the 'Holistic Balance Sheet', currently being developed by EIOPA, would force pension funds to move even further into low-risk asset classes such as government bonds – at the expense of investment in equities and other growth-generating assets.

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[3] The NAPF's *2014 Annual Survey* of its members showed that just 8% of UK private sector defined benefit schemes were still open to new members – down from 23% in 2009. 53% were closed to new members but still open for future accruals by existing members. 39% were completely closed.

[4] Research by Spence Johnson predicts that the total UK DC market could grow from €373 billion today to 1,060 billion by 2024.

- In designing a Capital Markets Union it is important to be mindful of the reality that capital is not constrained by the EU's borders. Providers of capital such as pension schemes are global investors and as such will assess the attractiveness of any investment opportunity presented against opportunities available to them in other jurisdictions; the same, of course, goes for investors outside the EU. In making any investment decision an investor will form a judgement based upon an assessment of the potential risks and rewards of any proposition. On this theme, high standards of governance, transparency and protection of minority shareholder rights should enhance the attractiveness of the EU market for both investors and issuers.

2. What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?

- The NAPF agrees with the Commission's approach: individual SMEs simply do not borrow sufficient amounts to make bond issuance possible, so some kind of packaging and securitisation of their borrowing is a logical solution. This is not, of course, a completely new concept; several investment trusts already operate in this area.

- There are three key challenges to overcome if this sector is to be expanded:

  - The first is the question of how this credit should be priced; the answer is not immediately clear. The price will, of course, have to reflect the costs involved in packaging different tranches of borrowing.

  - Second, the risks of this kind of securitisation must be made clear in order to avoid any repeat of the crisis of 2008.

  - The third challenge is that the existence of different insolvency regimes in each Member State makes Europe-wide securitisation very difficult.

- A solution – or at least a partial solution - lies in the standardisation of credit reporting, which is already possible. A useful first step would be for the EC to develop the understanding of this current activity to see how it could be further developed.

3. What support can be given to ELTIFs to encourage their take up?

- It is not clear what advantages ELTIFs offer to pension funds over other funds already available. The EC will have to make these more apparent if ELTIFs are to be utilised by institutional investors to any significant extent.

- Note that pension funds can already use Alternative Investment Funds (AIFs), although non-regulated AIFs are not currently available to those pension funds classed as 'retail' vehicles, such as the UK's local authority pension schemes.

- It will be important to ensure that high capital charges (for example, through Solvency II or other EU capital requirements regulations) do not become a barrier to investment in ELTIFs.

4. Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?

- No answer.

5. What further measures could help to increase access to funding and channelling of funds to those who need them?

- Policy-makers should put in place a clear pipeline of future infrastructure investment opportunities, to give pension funds the confidence to build due diligence capabilities and ensure the necessary funds are available when needed.

- One of the key barriers to pension fund investment in infrastructure is the challenge of assessing and managing risks with which they are not familiar, such as construction risk. Vehicles such as the Pensions Infrastructure Platform have the potential to develop the scale and in-house expertise to carry out these assessments and it is hoped this will be one way in which the PiP will make it easier for pension schemes to invest in infrastructure.

- A further barrier to infrastructure investment is the difficulty involved in daily pricing. DB and DC schemes have different requirements.

- Political and regulatory risk can be a major barrier to investing in infrastructure over the long term. The many shifts in the tariffs available for solar energy projects are a good example. Policy-makers at national and EU level should look to ensure a stable regulatory and fiscal framework.

- A Financial Transaction Tax would be an extra barrier to investment in infrastructure funds.

- One of the EU's aims should be to encourage a shift from state funding of pension provision to the development of funded pension schemes supported by contributions for employees and employers. This would build up substantial new sources of capital that would be available for investment. The regrettable developments in recent years in some of the newer Member States, where governments have raided pension schemes in order to plug their own deficits, have done great damage to this cause. This should be a key area for the EC's attention.

- In general, in order to maximise the allocational efficiency of the EU's Capital Markets there need to be greater levels of disclosure in the market rather than less. More transparency of information should enable more capital to flow more effectively.

6. Should measures be taken to promote greater liquidity in corporate bond markets, such as standardisation? If so, which measures are needed and can these be achieved by the market, or is regulatory action required?

- There is a case for standardisation - but not necessarily by the EU or national governments; market participants could make much of the running. The EC should consider what it can do to facilitate this kind of progress.

7. Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?

- Investors are increasingly incorporating non-financial considerations into their investment decisions and this will be further aided by the additional information to be provided by companies following the introduction of new non-financial reporting requirements via the Transparency Directive.

- A 'green' market is developing rapidly and there is no need for the EC to seek to standardise it. Indeed, there is a risk that this kind of policy intervention could stall the current pace of development and set the market in aspic.

- One challenge with 'green bonds' for pension schemes relates more simply to the way a pension scheme invests. Prior to committing capital to any specific investment, assets are allocated to an asset class - these are each defined by characteristics and associated benchmarks including expected returns and volatility as well as minimum liquidity requirements. In order to invest in any one of these asset classes an investment proposition would need to fit within the underlying characteristics. A green bond therefore needs to either be a liquid, government (or government guaranteed) bond class or offer the higher returns of a well-rated corporate bond class.
- Factors which impinge upon the ability to invest in 'green bonds' are therefore no different to other niche or less developed assets – liquidity, scale and understanding the risks. Pension schemes have a fiduciary duty to invest in the most commercially competitive bonds after considering price, credit risk and liquidity – it is unlikely any scheme would, or indeed could, apply a premium to the "green" label. As the supply of green bonds grows, however, it is likely that the attractiveness of these assets will increase.

8. Is there value in developing a common EU-level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

- A common accounting approach could help to overcome the present problems of inconsistency. This could help such companies attract investment in the long term and help in standardising SME information. The "SME" market itself, however, is very broad, including as it does genuinely small and simple businesses through to large and complex organisations. Any steps to harmonise an accounting standard should address this issue.

- In advancing this idea, the EU should be mindful of the international dimension; the need to maintain common principles and crucially the objective of enhancing investor confidence about investing in inherently risky securities.

9. Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross-border basis? If so, how should they be addressed?

- The NAPF is not aware of any such barriers.

10. What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

- Pension funds need a strong, transparent pipeline of suitable investment opportunities. So there is a case for a single, EU-co-ordinated website listing these projects. The information currently available, whether in the UK's *National Infrastructure Plan* or on the EC's website listing of infrastructure projects, does not give anything even remotely approaching the level of detail required by pension funds looking to do due diligence and assess the risks or returns in a particular investment opportunity. The vehicles for infrastructure investment exist; the question is whether there is significant demand.

- Investing in infrastructure in another Member State involves a high degree of political and regulatory risk – for example, whether the government will continue to support toll roads or the future level of subsidy for solar power. Again, any mitigation by the EU would be welcome. Currency risk is a further risk for UK schemes investing elsewhere in the EU.

- It is important to appreciate that risk appetite varies from one investor to another. Some pension investors would like to see the EC or national governments take away construction risk, as they are looking for low-risk, liability-matching assets. Others welcome construction risk, as they are looking for higher returns and accepting this risk helps them to achieve that objective.

- In setting up the PiP, the NAPF has encountered and overcome many of the same challenges that would be faced by any other institutional investor look to invest for the long-term. For example:

  - It is essential to recognise that infrastructure is a varied asset class with varied risks: the comparative risks involved in a public-private partnership ('PPP') hospital purchased on the secondary market and a greenfield offshore wind development are different and require different expertise.

  - Pension Funds themselves are a varied class of investor: the terms or structure that work for one fund will not necessarily work for all funds. Terms of investment opportunities must allow flexibility to be attractive to a wide range of investor.

  - Fees are crucial: fees need to be transparent, justifiable, sustainable in the long-term and structured in the interests of pension funds, not asset managers.

- The Green Paper assumes that SMEs are suitable for pension fund investment, but this is not necessarily the case. Pension schemes generally look for investments with moderate levels of risk and return; as such, direct investment is unlikely although investment through pooled vehicles or in securitised products may be more attractive – subject to risk and cost.

- Regarding start-ups, it is far from clear that this is an area into which IORPs should channel significant investment. Pension funds generally look for investments that deliver steady rates of return over the long term at manageable levels of risk. This ensures they can match their liabilities with suitable assets, manage their deficits and ultimately pay pensions. Start-ups rarely fit this profile and the performance track record of venture capital funds in the UK is not a strong one.

11. What steps could be taken to reduce the costs to fund managers of setting up and marketing funds across the EU? What barriers are there to funds benefiting from economies of scale?

- No answer.

12. Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets?

- No answer.

12.1 If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?

A. No answer.

13. Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

- Regarding IORPs, the starting point for any progress towards a genuine single market would be reform of the current IORP Directive's requirement for cross-border schemes to be fully funded at all times. This would a positive step towards strengthening the Single Market.

- The NAPF's discussion with pension schemes and employers indicate that there is some demand, albeit limited, for this kind of pension model from multi-national employers who would then be able to operate single pension schemes across EU borders. However, they would have to be confident that the gains would outweigh the significant transitional costs of merging separate schemes. Also, it is still not clear how a single pension scheme could operate across different national tax regimes.

- The key point is that the EC and EIOPA should work closely with employers in developing this new model. A new cross-border pension model will only succeed if it meets the needs of employers.

- The question of a '29th regime' for personal pensions is a separate matter, but policy-makers should be aware that many employers use 'Group Personal Pensions' to provide pensions in the workplace. The latest available figures, from 2013, show that 12% of employers provided access to a Stakeholder pension scheme and while 5% provided a Group Personal Pension scheme.[5] It is important that policy development work on the '29th regime' does not impose extra regulatory requirements on these schemes and takes full account of employers' needs.

14. Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund1 managers to run these types of funds?

- No answer.

14.1 What other changes if any should be made to increase the number of these types of fund?

- No answer.

15. How can the EU further develop private equity and venture capital as an alternative source of finance for the economy?

- Pension funds need significant scale to be able to invest in private equity. This is one of the reasons why, at present, UK pension investment in private equity and venture

[5] *Employers' Pension Provision Survey 2013*, Department of Work and Pensions. A Stakeholder scheme is a type of personal pension scheme that must meet certain criteria concerning charges, governance and freedom to stop and start contributions and switch to a different provider without being charged.

capital is almost exclusively the preserve of larger defined benefit (DB) rather than defined contribution (DC) schemes.

- The NAPF's *Annual Survey 2014 shows* that 20 per cent of UK defined benefit pension schemes have investments in private equity or venture capital in 2014. Of these schemes, the average allocation to the asset class was 7.0 per cent of assets – an increase from 5.3 per cent in 2013.

- Private equity and venture capital are not currently a suitable asset class for DC schemes, partly because of scale, but also because the pricing of this kind of investment – they are illiquid and thus difficult to price - is not compatible with a world in which government-imposed charge caps and daily pricing requirements will increasingly push DC pension schemes into passive and 'vanilla' investments.[6]

- EC policy-makers should note that the UK pensions landscape is changing quite rapidly. Auto-enrolment has brought an extra 5.2 million new savers into workplace pensions since its launch in October 2012 – a major advance. The vast majority of these savers are in DC schemes, so we can expect the volume of assets managed in DC schemes to grow rapidly. One independent forecast predicts DC assets growing from £277 billion (around €384 billion) today to £787 billion (1.09 trillion) by 2024. So it is vital that policy-makers ensure policies are 'future-proofed' so they are suitable for DC schemes' investment requirements once their scale has substantially increased.

15.1 In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

- See previous answer.

16. Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

- No answer.

17. How can cross border retail participation in UCITS be increased?

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[6] The UK has a 0.75% charge cap on DC schemes used for auto-enrolment and there is some political pressure for this cap to be reduced to a lower level in the future.

- No answer.

18. How can the ESAs further contribute to ensuring consumer and investor protection?

- The ESAs already have sufficient powers. It is important to recognise that pension policy remains a Member State competence and there is no need to hand further powers to the ESAs.

- The NAPF liaises in particular with EIOPA, and we are concerned that EIOPA is rapidly extending its remit without sufficient accountability either to stakeholders or political institutions. EIOPA's decision to press ahead with the Holistic Balance Sheet on its own initiative is a good example of this. This initiative is also a good example of individual supervisory authorities working in isolation and potentially impeding the broader cross-department objectives of the Commission. In order to achieve progress towards a Capital Markets Union it will be important that regulation is joined up – to this end it may be advisable for the Commission to consider assessing each new legislative or regulatory proposal through a CMU lens.

- Rather than new powers for the ESAs, the NAPF would prefer to see an increase in accountability.

19. What policy measures could increase retail investment?

- No answer

19.1 What else could be done to empower and protect EU citizens accessing capital markets?

- No answer

20. Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

- No answer

21. Are there additional actions in the field of financial services regulation that could be taken to ensure that the EU is internationally competitive and an attractive place in which to invest?

- The European Commission should continue to leave EIOPA's proposals for a Solvency II-based Holistic Balance Sheet for IORPs out of the EC work programme. These proposals, which have been opposed by the full range of social partners (including PensionsEurope, the ETUC and BusinessEurope) would undermine pension provision by increasing the cost of funding defined benefit schemes, forcing employers to replace them with DC schemes where all the risks fall on the members.[7]

- Policy-makers should also ensure that new regulations such as those for capital requirements (e.g. Solvency II and CRD IV) do not impede the objectives of the CMU by penalising investment in infrastructure and other long-term assets.

22. What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?

- Given that pension schemes invest across global markets, it will be important for the EU to co-operate closely with other economies, especially the USA, over the development of capital markets regulation.

- Enhancing minority shareholder protection would give international investors greater confidence and in turn boost international investment. The associated reduced cost of capital for European companies would be positive for broad-based economic growth.

23. Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

- The NAPF is concerned that a tranche of current proposals from global regulators could cause a damaging lack of liquidity in the markets. Examples include the proposals from the Bank of International Settlements and IOSCO on margin requirements for non-

[7] EIOPA's Quantitative Impact Study (4 July 2013) demonstrated that the original Holistic Balance Sheet proposal would (on the benchmark scenario) have increased the deficits of UK defined benefit schemes by €176 billion (c.£150 billion) even after allowance had been made for the additional support provided by sponsors and the Pension Protection Fund.

centrally cleared derivatives[8] and potential requirements for central clearing of OTC derivatives under the EU's EMIR legislation.

- Pension funds are currently exempt from EMIR's requirement for central clearing of OTC derivatives. The European Commission has extended this exemption until August 2017, with potential for a further one-year extension until August 2018. The key reason for the extension – as explained in the EC's February 2015 report[9], is that the market has not yet developed satisfactory proposals that would allow pension funds, which do not hold substantial quantities of cash, to use or convert other assets, chiefly bonds, into collateral.

- NAPF pension fund members have around €150 billion invested in in equities across the EU as well as significant investments in corporate bonds across Europe. As such the effective use of good-quality investment research is clearly of benefit to our pension fund members – the clients of investment managers – as they should benefit from the improved performance emanating from the use of this research in what is a highly competitive market. It is self-evidently in the interests of pension fund clients that there is a competitive research market providing coverage of small and large cap stocks in local and international markets. Efficient markets lower the cost of capital and assist the free movement of capital to where it can be best used, helping drive economic growth.

- We are particularly supportive of the proposals within MiFID II to change the current model whereby client money via dealing commission is used to purchase investment research. This model creates an inherent conflict of interest for investment managers and results in an over-use of and over-supply of external research which is purchased without the level of rigorous due diligence and oversight that a firm would apply when spending its own money.

- The proposed requirement to have a specific research budget which is agreed with clients is an important step towards breaking the link with trading volumes. The NAPF is aware that concerns have been expressed about the potential negative impact upon the research coverage of SMEs. Our view is that, while these concerns are genuine, their likely impact is difficult, if not impossible, to assess properly and glosses over the already very poor level of coverage of SMEs. The World Federation of Exchanges estimates 35-40% of publically listed companies have no analyst coverage). In general our pension fund members are of the view that if significant reform were to be

[8] http://www.bis.org/bcbs/publ/d317.pdf

[9] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0039&from=EN

introduced then the most significant impacts would likely be short-term and the market would adjust in relatively short order. The resultant market would in turn be more competitive, include more provision from independent and other providers and act more transparently in the interests of the end clients for whom the system should be operating.

24. In your view, are there areas where the single rulebook remains insufficiently developed?

- The EU has introduced a substantial volume of new financial markets legislation in recent years, and much of this (eg EMIR) is still being implemented. The focus should be on proportionate and practical implementation, rather than on further extensions of the rulebook.

- The European Commission has stressed its commitment to prioritising policies to promote jobs and growth; the NAPF strongly supports this agenda. Again, this suggest that further extensions of the rulebook should be much lower priorities than other policies discussed in this Green Paper, such as promoting long-term investment in infrastructure.

25. Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a Capital Markets Union?

- The ESAs already have sufficient powers.

- The NAPF liaises in particular with EIOPA, and we are concerned that EIOPA is rapidly extending its remit without sufficient accountability either to stakeholders or political institutions. EIOPA's decision to press ahead with the Holistic Balance Sheet on its own mandate is a good example of this.

- Rather than new powers for the ESAs, the NAPF would prefer to see an increase in accountability.

26. Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?

- No answer.

27. What measures could be taken to improve the cross-border flow of collateral?

- Reforms in this area should recognise the particular circumstances of long-term investors. Pension Funds hold only small amounts of cash[10], so posting substantial amounts of collateral presents a major challenge. This was acknowledged in the EC's recent report on the pensions industry's readiness for central clearing under EMIR, which recommended extending the pension schemes exemption until August 2017.[11]

- Any reform in the area of collateralisation should dovetail with the EC's forthcoming review of EMIR, which is expected to start later this year.

27.1 Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

- No answer.

28. What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?

- The NAPF was supportive of many of the original objectives of the Commission's proposed revisions to the Shareholder Rights Directive, namely to further encourage and better facilitate effective long-term shareholder engagement with investee companies across borders. An engaged shareholder base alongside high standards of governance, transparency and protection of minority shareholder rights should enhance the attractiveness of the EU market for both investors and issuers, and so play a role in driving economic growth across Europe.

- Of all the areas of attention within the Shareholder Rights Directive the most beneficial from the perspective of investors was with respect to related party transactions. Disappointingly, however, the Commission's original proposals have since been significantly diluted. Within the EU there is a diversity of corporate structures and at

[10] The NAPF *Annual Survey 2014* showed that the average (mean) holding in cash or other short-term instruments for a private sector defined benefit scheme was just 2.7% of total assets.
[11] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0039&from=EN

times investors are concerned that the value of their assets could be eroded by those in positions of dominance, particularly in companies that have significant controlling shareholders. The inherent conflicts which arise between related parties can, and often do, result in actions which significantly erode value for shareholders to the benefit of the individuals involved. More consistent and more enhanced shareholder rights across the EU would be much welcomed by investors, providing them with greater confidence that their assets will not be expropriated by those in positions of dominance.

- There are other matters of a similar theme that could be helpfully looked at in order to improve ownership rights on a pan- European basis such as: the class test provisions; the impediments to voting; the right of pre-emption; access to boards; 'one share one vote'; and concert party rules.

- Class test provisions safeguard shareholders' rights when they could potentially be diluted. For example, for major acquisitions or disposals and reverse takeovers it is preferable if shareholder approval should be obtained and the matter voted on in order that they may have an active influence over a company on a matter which could significantly affect the value of their investment.

- More broadly, certain Member States have introduced 'incentives for long-term shareholders' over the past year which have caused significant consternation amongst investors. There have also been efforts within the European Parliament to introduce requirements for Member States to bring forward incentives for long-term shareholders. Our members are strongly supportive of the one-share one-vote one-dividend or proportionality principle. Whilst we understand the rationale behind proposals to put in place mechanisms to promote long-term shareholding - such as additional voting rights, tax incentives, loyalty dividends or loyalty shares, our members are concerned that, instead of rewarding and incentivising long-term shareholding, such mechanisms may be counter-productive. We contend that these 'incentives' risk undermining both the fundamental objective of improved shareholder engagement and the wider agenda of deepening market-based finance through a Capital Markets Union.

- The granting of additional control rights to long-term owners in particular runs the risk of enhancing the influence of dominant founders or controlling shareholders and undermining and disenfranchising engaged minority investors. Such a scenario could make the European market much less attractive for investors with the ability to invest their capital globally.

29. What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

- The NAPF acknowledges that it would be difficult to develop a fully-fledged pan-European capital market without harmonisation of national insolvency regimes. However, this appears well beyond the scope of the current project and would, in all likelihood, be politically impossible. The EC should instead focus on measures that can actually be delivered.

30. What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

- The NAPF has no proposals for tax reform at EU level.

- We would draw attention, however, to the risks for IORPs in the current proposal for a Financial Transaction tax to be introduced in 11 EU Member States.

- The FTT would damage the interests of workers and savers by increasing the cost of investing – leading to lower pensions or higher contributions.

- The FTT would hit pension schemes in Member States beyond the 11 participating nations. Under the original EC proposals tabled in 2012, if a scheme bought shares in a French or German company, for instance, or dealt with the UK branch of a bank from one of the 11 participating nations, then it would pay the tax.

- Two NAPF pension schemes have calculated the cost of the FTT at €35m and €5m a year in terms of extra transaction costs for their own schemes – assuming no change in investment behaviour.

- The NAPF accepts that there is a case for tackling some aspects of market behaviour to encourage long-term responsible investment. But better stewardship, not a new tax, is the best way forward .

- An exemption for pension schemes would be of only modest value unless fund managers, brokers and the rest of the investment chain were also exempt in respect of their pensions-related business.

31. How can the EU best support the development by the market of new technologies and business models, to the benefit of integrated and efficient capital markets?

- No answer.

32. Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

- No answer.