Association Européene des Institutions Paritaires
European Association of Paritarian Institutions

# The role of paritarian institutions of social protection in the creation of the Capital Markets Union

## AEIP Position Paper

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## Key messages

The current momentum is an opportunity to accelerate the creation of the Capital Markets Union (CMU) through the parallel enhancement of paritarian institutions of social protection.

AEIP supports the overall objective of the CMU as a way to better connect savings to investment and to strengthen the EU financial system by enhancing additional means of risk-sharing, providing alternative sources of financing, and increasing options for institutional investors.

AEIP and paritarian institutions of social protection - including occupational pension and healthcare funds, first pillar bis pension schemes as well as provident institutions - can play a key role in the development of the CMU. Especially in the light of the unprecedented and detrimental coronavirus pandemic, paritarian institutions should have an even more pivotal role in funding the CMU initiative.

Paritarian institutions have an important social function in supporting the EU economies and citizens. They ensure adequate benefits for old age income, healthcare and long-term care services while they work as much-needed automatic stabilizers in times of economic strain. Thanks to their joint decision-making process and management by the social partners, they promote and ensure transparency and inclusiveness, acting in the best interest of their participants and beneficiaries.

At the same time, paritarian institutions of social protection are important institutional investors and can contribute to fostering long-term investment and sustainable economic growth. They also have a substantial role in maintaining financial stability. They often act counter-cyclically by maintaining their long-term strategic asset allocation in stressed market conditions, meaning they rebalance and buy assets whose prices have diminished abruptly. Importantly, paritarian institutions allow for individuals to safely save at a very low cost and with high real returns. In that regard, they are essential for investing in capital markets and the deepening of the CMU.

In the current economic environment of persisting low interest rates and the detrimental effects of the Covid-19 pandemic, there is a growing interest among paritarian institutions of social protection to invest in the real economy. This includes investments in alternative asset classes such as infrastructure and private equity.

Given the importance of paritarian institutions of social protection for the creation of the CMU, the EU should support growth in the second pillar pension sector. In particular, we urge the European Commission to provide for policy measures that will promote second pillar savings, ensure that individuals start saving collectively from early on in their career and safeguard that the financial burden does not fall exclusively on their shoulders, not having any available collective mechanisms of protection. This would enable households to allocate savings towards financial market instruments with decent returns, rather than bank deposits with real negative returns, and deepen European capital markets as a result.

Furthermore, we call for decisive policy instruments at European and national levels that would back up and enhance capital-based and collective systems of social protection managed by social partners, thus assisting to the channeling of savings towards a European CMU. This can be done with a wide array of short-term, as well as long-term measures, including:

- the enhancement of coverage for collective schemes and the introduction of quasi-mandatory or nudge mechanisms, such as automatic enrolment;

- the creation of tax and financial incentives for both employees and employers to opt for supplementary benefits schemes;
- the promotion and support for financial literacy programmes as a means to strengthen the trust of the general public in collective social protection schemes;
- the development of a proper framework for sustainable finance, which presupposes the availability of comparable and reliable data for the purposes of sustainable finance disclosures and non-financial reporting;
- a proper regulatory framework that would alleviate barriers to cross-border investments and find a balanced risk-based approach for investors such as the paritarian institutions of social protection;
- an EU tax policy which does not create any additional burden to the functioning of occupational funds as investors in the EU economy. For example, we suggest not including paritarian social protection schemes within the scope of the Financial Transaction Tax (FTT), which disregards the specificities and social character of occupational pension funds;
- the development of multi-pillar pension tracking services, both at the EU and national level, which would increase transparency and information to individuals, thus supporting a properly functioning CMU.

## AEIP's Recommendations for supporting paritarian institutions and promoting the CMU

AEIP supports the overall objective of the CMU as a way to better connect savings to investment and strengthen the EU financial system by enhancing additional means of risk-sharing, providing alternative sources of financing and increasing options for institutional investors. Furthermore, AEIP believes that the EU institutions have the responsibility to ensure that the European businesses and investors have access to strong, dynamic and more integrated capital markets, while risks to financial stability are properly managed. The creation of the CMU goes into this direction and that is why we support the launch of such an initiative.

***Key Role of paritarian funds from a social perspective***

Given their economic and social role, paritarian institutions of social protection - including occupational pension and healthcare funds, first pillar bis pension schemes as well as provident institutions - are part of the solution in the creation of the CMU. Such institutions can ensure adequate old age income to EU citizens, while supporting the creation of a strong CMU by channeling their investment flows towards the numerous businesses embedded in the real economy.

Given the recent strain of the Covid-19 effects on the EU economy as a whole, the need for enhanced financing towards small and medium enterprises in particular is even more timely. Now more than ever, European citizens need a safe and transparent way to enhance their long-term savings. At the same time, it is important to recognize that numerous European companies are in great need of funding, since the current banking system cannot provide them with sufficient credit. Lastly, the CMU would serve the Economic and Monetary Union, which in turn would enhance the EU Banking Union, since capital markets could be a way of ensuring the selling of non-performing loans.

Finally, measures to secure growth and investments are key in maintaining the sustainability and adequacy of the European welfare model and for this reason paritarian institutions play a pivotal role in the CMU initiative. This holds especially true in the light of the aftermath of the unprecedented and devastating Covid-19 pandemic. Importantly, paritarian institutions have the potential to ensure old age income adequacy and services for individuals, and work as much-needed automatic stabilizers in times of financial crises and economic strain, combining the interests of both workers and employers. Moreover, they act as shock absorbers during economic downturns by providing liquidity while they avoid short-term investment decisions driven by market panic. The counter-cyclical role of IORPs in particular has been recognized by EIOPA during its most recent Stress Test exercise[1].

Based on the principle of solidarity, paritarian institutions are jointly managed by social partners. This ensures that the interests of all stakeholders are reflected in collective agreements in a transparent and inclusive manner. As a result, such institutions should not be treated as purely financial service providers. Their social function and the triangular relationship between the employee, the employer and the IORP should be adequately acknowledged and supported.

***Key Role of paritarian funds from a financial growth and financial stability perspective***

Together with their pronounced social role, paritarian institutions of social protection are key institutional investors and contribute to fostering long-term investment as well as economic growth. They are 'by nature' long term investors and therefore are a true partner for financing sustainable growth and the green transition. In addition, having a long-horizon focus allows paritarian institutions to invest in diversified asset classes that are not accessible to true short-term investors, such as illiquid, private assets.

Furthermore, paritarian institutions of social protection have a substantial role in maintaining financial stability. They can avoid panicked short-term oriented sell-outs and maintain their long-term strategy when asset prices diminish abruptly. In the current economic environment with persisting low interest rates, there is a growing interest among paritarian institutions to invest in the real economy, including alternative asset classes such as infrastructure and private equity. Thus, in addition to higher expected returns in combination with potentially lower risks, the investments of paritarian institutions make a significant contribution to the European economy as a whole. Despite this, the maturity of capital markets differs considerably among countries. It is not appropriate, therefore, to adopt a 'one-size-fits-all' approach. The main challenge for occupational funds (which can be managed by IORPs, life insurance undertakings or providence institutions) remains the low interest rate environment that affects both DB and DC schemes. As the IORP II Directive recognizes in particular, the way in which IORPs are organized and regulated varies significantly between Member States.

***Promotion of paritarian schemes as a means for a stronger CMU***

The current momentum is an opportunity to accelerate the creation of a true CMU through the parallel enhancement of paritarian institutions of social protection. As the report of the Next CMU group[2] also highlights, "increased participation in occupational pension schemes can become a substantial catalyst for creating new demands for long-term investments in equity". This can be done with a variety of

[1] EIOPA, 'EIOPA publishes the results of the 2019 Occupational Pension Stress Test', Press Release, 17 December 2019. Please see link here.

[2] The Next CMU High-Level Group, 'Report to Ministers and presented to the Finnish Presidency', October 2019. Please see link here.

measures, such as the enhancement of coverage for occupational schemes and the introduction of quasi-mandatory or nudge mechanisms, including automatic enrolment. More broadly, another measure for promoting occupational institutions could be the creation of tax and financial incentives for both employees and employers to opt for supplementary benefits schemes. The CMU should recognize the importance of such institutions for adequacy of pensions and other benefits that guarantee a good standard of living.

For these reasons, we call for decisive policy measures at the EU and national level to back up and enhance capital-based and collective systems of social protection managed by social partners, thus assisting the channeling of savings towards a European CMU. Several policy recommendations recently put forward by the High-Level Group of Experts on Pensions[3] are a good basis for the promotion of second-pillar pensions in particular, which are seen as a collective vehicle of risk-sharing during old age.

Over the last decades the financial burden of welfare services has gradually shifted to the individual. Consequently, it is important for occupational funds to be supported by appropriate policy instruments in strengthening their long-established model of collective risk-sharing, since this is a structural characteristic deeply embedded in European economies and societies. Therefore, decisions over governance of pensions, healthcare or long-term care benefits should be given to inclusive and transparent collective institutions, in order to assist to the individuals' choices with the aim to protect them as best as possible against future risks.

Given the importance of paritarian institutions for the creation of the CMU, the EU should prioritize growth in the second pillar pension sector. In particular, the EU should promote second pillar savings, ensuring sufficient incentives for individuals to start saving from early on in their career. It should also promote collective systems that offer adequate investments at low costs resulting in better investment returns. This will benefit pension adequacy and at the same time increase the money available to invest in the real economy.

***Strengthening the trust of the general public in collective social protection schemes***

The trust of the general public in the system is an important prerequisite for the creation of the CMU. Trust will come only if EU citizens understand that paritarian funds play a key role in providing adequate old age income, healthcare benefits as well as other benefits. It is crucial that European citizens comprehend the challenges of the welfare systems and increase their support towards complementary schemes in particular. To do that, we need to make sure that clear and accessible information are available to them. Going even further, a basic requirement for the enhancement of collective mechanisms of social protection is the promotion of financial literacy. This is a fundamental vehicle that empowers citizens to take better life decisions and contributes to the consolidation of solidarity within the existing collective systems. We urge the European Commission to support with its available mechanisms the development of financial literacy programmes for employers and employees at national level.

[3] High-Level Group of Experts on Pensions, 'Final report of the High-Level Group of Experts on Pensions, December 2019

***The development of an appropriate sustainable finance framework as a CMU prerequisite***

Another important prerequisite for enhancing significantly capital flows is the development of a proper framework for sustainable finance and sustainable investments. This implies the availability of comparable and reliable data for the purposes of sustainable finance disclosures and non-financial reporting. The consolidation of the EU taxonomy on sustainable economic activities is a first step, which will ensure a more aligned framework for the integration of well-thought criteria for the environmental sustainability of investments. This framework has the potential to lead to increased awareness and commitment, self-organization and better decisions from the side of institutional investors and investees, but also from the side of the companies and sectors that our members invest in.

***Fewer barriers to cross-border investment and a more balanced regulatory stance***

A properly functioning CMU should alleviate barriers to cross-border investments and give the appropriate incentives to investors. Participation in the CMU – as also in green finance and sustainable growth - requires a certain risk tolerance. Paritarian schemes fully support a risk-based approach under the condition that this keeps a right balance between sustainability and adequacy of provided benefits.

As regards occupational pensions in particular, the IORP II Directive explicitly states that IORPs are long-term investors, and therefore they should be able to opt for an asset allocation that suits their precise nature and duration of their liabilities. In that sense, the EU recognizes a risk-based framework in the interest of the sponsors, members and beneficiaries. However, as part of the policy legacy created at aftermath of the 2009 financial crisis, EIOPA promotes a common framework for risk assessment that will lead to more de-risking either by abolishing the benefit, shifting the risks towards the individual, or by moving away from investing in the real economy.

***Aligning different EU policies***

We believe that the CMU action plan gives a window of opportunity to align different EU policies that today contradict each other instead of strengthening.

Over the last decade our society has identified several challenges that require immediate action. The pension adequacy report 2018 shows the challenges pension systems in Europe will be facing due to the demographic evolution. To cope with the challenges of climate change the EU is examining how to integrate sustainability considerations into its financial policy framework in order to mobilise finance for sustainable growth. With the CMU the EU wants to mobilise capital in the Europe to provide businesses with a greater choice of funding at lower cost and make the financial system more resilient.

Policy makers expect pension funds to contribute significantly in tackling these challenges. And indeed, mostly run as non-profit organisations, jointly managed by employee and employer representatives, pension funds providing occupational pension plans play an important role in providing for an adequate pension.

Due to the nature of their liabilities, pension funds are 'by nature' long term investors and therefore are a natural partner to finance sustainable growth. In the current economic environment with persisting low interest rates we also see a growing interest among pension funds to invest in the real economy including alternative asset classes such as infrastructure and private equity. Although pension funds are a natural partner to help to tackle the challenges mentioned above, we see some European initiatives that makes it increasingly difficult for pension funds to fulfil this role.

Unfortunately, other initiatives at the EU level are not aligned with the EU policies (pension adequacy, sustainable growth and CMU).

Financing sustainable growth and participating in the CMU requires a certain risk appetite. IORP II fully recognizes the long-term investment strategy of pension funds and respects a risk-based framework in the interest of the sponsors, members and beneficiaries. However, as a consequence of the financial crisis, EIOPA promotes a common framework for risk assessment that will lead to more de-risking either by abolishing the pension benefit, shifting the risks towards the individual, or by moving away from investing in the real economy.

The pension fund sector fully supports a risk-based approach under the condition it keeps a right balance between sustainability and pension adequacy. Only such approach can allow pension funds to continue taking risk by investing in sustainable growth and the CMU. Second pillar pension plans supplement social security pensions and as such are very heterogeneous within Europe, and therefore one-size-fits-all approach does not work.

The EU should support growth in the second pillar pension sector by supporting second pillar savings, making sure that individuals start saving at effective levels early in their career and promote collective systems that offers adequate investments at low costs resulting in better investment returns. This will benefit pension adequacy and at the same time increases the money available to invest in the real economy and as such support innovation and sustainable growth.

***Excluding paritarian schemes from the FTT scope***

Relevant to the CMU, certain initiatives of the EU tax policy represent a burden against strengthening the role of occupational pension funds as investors in the EU economy. In particular, plans for a Financial Transaction Tax (FTT), which would include occupational pension funds in its scope, are incoherent with the goals and strategy paved in the CMU. Occupational paritarian institutions should be exempted from the scope of the FTT, since they are not mere financial institutions.

We believe that the proposed FTT puts a constraint on the ability of pension funds to achieve their overarching aim, which is the provision of adequate pensions to their members. As a result, an FTT on occupational paritarian pension funds will affect the retirement income of people in Europe and the funds' capital allocation to the real economy. Both these consequences would impede the goals of the CMU.

***Support for the development of National and European Pension Tracking Services***

Given the increasing number of mobile workers in the EU single market, the European Commission –as well as the NextCMU group- has stressed the importance for developing web-based cross-border pension tracking services. These services would help mobile workers to follow their pension rights accrued in different Member States and pension schemes in the course of their career. AEIP welcomes and supports this proposal, since we consider that these services must include future pension entitlements not only for occupational pensions, but also for the statutory pension. This is particularly relevant in order to allow citizens working across the EU to have a comprehensive overview of their future pension benefits. For that reason, AEIP is glad to be part of the EU partner consortium for the development of a European

Tracking System on pensions[4]. The establishment of tracking systems is a task for the society as a whole, which should be borne by the public. Otherwise, the costs could exceed financial resources of IORPs or could be passed on to the beneficiaries.

All in all, AEIP and its members support the creation of the CMU, hence the promotion of the role of paritarian institutions of social protection is an important element for its realization.

AEIP remains available to contribute with its expertise in all future steps towards the creation of the CMU.

[4] For more information, please see here.

**AEIP Disclaimer**

AEIP represents the European Paritarian Institutions of Social Protection in Brussels since 1997. The Association gathers 22 leading large and medium-sized Social Protection Management Organizations which equally represent the employees and the employers through a joint governance scheme; plus 39 affiliates from 22 countries

AEIP represents its members' values and interests at the level of both European and International Institutions. In particular, AEIP - through its working groups - deal with EU coordinated pension schemes, pension funds, healthcare schemes, unemployment schemes, provident schemes and paid holiday schemes.

Owing to the quality of its members and to the delegation of powers conferred to its Board, AEIP aims at becoming the leading body for the promotion of balanced paritarian social protection systems in Europe. AEIP promotes and develops programs and orientations aiming at the sustainability of paritarian social protection systems at local level taking into account the national specificities aiming at ensuring social cohesion in Europe.

Based thereon, AEIP prepares recommendations, proposes local programs and influences European decisions to safeguard and promote the interests of its members. AEIP thinks ahead and anticipate modern paritarian social protection systems that take into account changing economic and societal pattern. It furthermore seeks to find a new balance between and across generations.