DG FISMA consultation paper on the possible impact of the CRR and CRD IV on bank financing of the economy

Insight Investment response

October 2015

A BNY MELLON COMPANY[SM]

Insight
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Background to Insight Investment

Insight Investment is responsible for EUR541bn of assets under management,[1] predominantly on behalf of European pension funds and other long-term savings institutions.

The potential impact of CRR and CRD IV on pension funds and the European economy

Pension funds play a significant role in the European economy. With trillions of euros in assets under management,[2] they are key investors across the European markets, and play an increasingly important role in investments and financing of long-term projects including infrastructure. We therefore believe that regulators considering how to implement new bank capital rules, without having an adverse impact on the economy, should also take any impact on pension funds into account. We believe the CRR and CRD IV rules could have an adverse impact on pension funds.

European pension funds use derivatives to manage the risks related to their financial solvency. Under other derivative reforms such as the European Market Infrastructure Regulation (EMIR), policy makers have recognised that while pension funds have substantial assets under management, only a small proportion of this is held in cash or similar very liquid assets. In light of this, policy makers have limited the scope of EMIR and have provided certain exemptions to ensure that pension funds can still use derivatives to manage risk without incurring disproportionate costs as a result of regulation. This ensures that pension funds are able to carry on playing an important role in the economy through investment and providing income to pensioners. We are concerned that aspects of the CRR and CRD IV rules may undermine these efforts.

Specifically, EMIR policy makers recognised that a requirement to post only cash as variation margin on cleared derivatives could force pension funds to sell other investments, leading to disproportionate costs and lower potential growth in the future. The policy makers therefore have not required pension schemes to clear derivative contracts until a more appropriate clearing solution is developed.[3]

Against this background, the importance of the non-cleared over-the-counter (OTC) derivative markets for pension funds is clear. However, the CRD IV bank capital rules include strong incentives for banks to receive only cash as variation margin for non-cleared OTC derivatives positions. This would force pension funds to post variation margin in cash for non-cleared trades, leading to the same issues that would arise if they were forced to clear derivatives under EMIR and required to post variation margin in cash.

Furthermore, we believe EU policymakers should continue to ensure the CVA exemption provided to banks in relation to trades with pension funds remains in place, to keep the non-cleared OTC derivative markets workable for pension schemes.

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[1] Source: Insight. Data as at 30 June 2015. Assets under management are represented by the value of cash securities and other economic exposure managed for clients. Reflects the AUM of the Insight Group (Insight), which includes Insight Investment Management (Global) Limited, Pareto Investment Management Limited, Insight Investment Funds Management Limited, Cutwater Investor Services Corporation and Cutwater Asset Management Corporation (Cutwater Asset Management). Cutwater Asset Management is owned by BNY Mellon and operated by Insight. Base AUM reported in GBP, FX rates as per WM Reuters 4pm Spot Rates.

[2] See page 18, *Baseline report on solutions for the posting of non-cash collateral to central counterparties by pension scheme arrangements*, published by the European Commission (25 July 2014). "The aggregate assets of the occupational pensions industry across the EU28 were just over €5.2 trillion in 2012 according to PensionsEurope and the OECD." The report is available online at: http://ec.europa.eu/finance/financial-markets/docs/derivatives/150203-external-study_en.pdf

[3] See the extension of the temporary exemption provided to pension funds in EMIR (5 June 2015), available online at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015R1515

In general, we request that EU policymakers and international regulators ensure that there are no unintended consequences to pension funds or to the wider economy as bank capital rules are developed. Given the above issues, we would urge policy makers to consider these issues before the bank capital rules are finalised.

Notes

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