<u>Reaction of Timeos Pensionservices to the Financial Stability Board's consultative document on 'Structural vulnerabilities of asset management activities'</u>

This is the reaction of Dutch pension service provider Timeos Pensioendiensten to the Financial Stability Board's 'Consultation on structural vulnerabilities of asset management activities'. In our reaction, we provide our views on most of the questions set out in the consultation. We also highlight the most important issues connected to asset management and financial stability that we see from a pension fund perspective.

> **Q1:** *Does this consultative document adequately identify the structural vulnerabilities associated with asset management activities that may pose risks to financial stability? Are there additional structural vulnerabilities associated with asset management activities that the FSB should address? If there are any, please identify them, as well as any potential recommendations for the FSB's consideration.*

Answer:

We would like to make several observations to the consultation's scope and the position of pension funds in general.

- We applaud the FSB for addressing financial stability issues. We encourage the FSB to further look into this issue using a multifaceted and multidimensional approach, to avoid excessive focus and regulation of a single issue, and to assess the (unintended) interactions and consequences of legislation.

- We endorse FSB's stance that stability of financial markets as a whole is not necessarily achieved by making each individual market participant as safe as possible. We believe that financial stability also doesn't increase by more legislation. Instead, it is important to look at the (unintended) interactions and consequences for financial markets that arise from existing and proposed individual measures, and to adopt new legislation only when there is a clear added value.

- Retail and institutional investors are very different. Existing regulation already treats those two differently (see for example UCITS regulation). We think that this difference is justified. The FSB could take these existing differences into account more explicitly, to define more differentiated and targeted measures for these different types of investors.

- In general, pension funds are financial market participants that add financial market stability by their portfolio rebalancing strategies. Moreover, pension funds tend to invest for the longer term and to hold on to assets through the business cycle, contributing to financial stability further.

- Some regulation has unintended consequences for pension funds and other end users of financial services, and may therefore turn out destabilizing instead of stabilizing. This is the case of EMIR, and of Basel III's Net Stable Funding Ratio and Leverage Ratio Framework. These regulations cause high liquidity requirements for end users in times of stress on financial markets. This could contribute to liquidity freezes and fire-sale spirals, destabilizing financial markets.

***Q4**. In your view, is the scope of the proposed recommendations on open-ended fund liquidity mismatch appropriate? Should any additional types of funds be covered? Should the proposed recommendations be tailored in any way for ETFs?*

Answer:
A broad approach is preferable, to avoid a focus that is too narrow and misses some of the broader implications. Therefore, the recommendations should apply to all open-end funds, including ETFs, both liquid ones and ETFs on relatively illiquid assets, such as high yield bonds. Not including these could leave unintended gaps.

Q5. *What liquidity risk management tools should be made available to funds? What tools most effectively promote consistency between investors' redemption behaviours and the liquidity profiles of funds? For example, could redemption fees be used for this purpose separate and apart from any impact they may have on first-mover advantage?*

Answer:

Liquidity Risk Management tools such as in kind transfer of assets and redemption fees appear usable. In any case, first mover advantages should be reduced as much as possible, and not be favoured by Liquidity Risk Management tools

In market circumstances of stress, the investment fund should have the discretionary power to use liquidity risk management tools, being in the best position to determine what would be an effective and necessary tool. The list of eligible tools should be known up-front to investors, so that investors are fully aware of the potential measures that can be taken in case of stress.

Q6. *What characteristics or metrics are most appropriate to determine if an asset is illiquid and should be subject to guidance related to open-ended funds' investment in illiquid assets? Please also explain the rationales.*

Answer:
We define illiqiduity as follows: the inability to quickly sell an asset without affecting the market price of the asset. Exact definitions for 'quickly' are hard to provide, as these are asset specific, and also depend on the size of the position being sold.

We note that there may exist multiple reasons for an asset being illiquid. Illiquidity may signal that there are few parties interested in buying, may be caused by a lack of standard documentation (so that due diligence and negotiations take up substantial amounts of time) or be caused because the investment itself is not fully comparable with other investments. These different drivers of illiquidity may cause different definitions of 'illiquidity' to be appropriate for different asset classes.

Q7. *Should all open-ended funds be expected to adhere to the recommendations and employ the same liquidity risk management tools, or should funds be allowed some discretion as to which ones they use? Please specify which measures and tools should be mandatory and which should be discretionary. Please explain the rationales.*

Answer:
As we have indicated in our answer to Q5, open-ended funds should have some discretionary power in which liquidity risk management tools to use, as they are in the best position to assess what tool to use given the specific situation. However, the list of eligible measures should be available upon request, and should be known up front to investors.

Q8. *Should authorities be able to direct the use of exceptional liquidity risk management tools in some circumstances? If so, please describe the types of circumstances when this would be appropriate and for which tools.*

Answer:
In some exceptional market circumstances, it could be beneficial if authorities <u>make available</u> some liquidity risk management tools. The tool that comes to mind most prominently is direct access to central bank lending for investors. This may be the best way to meet increased liquidity needs in case of a liquidity crunch, and thus prevent 'runs' on investment funds for large-scale withdrawals of assets. Such liquidity needs may arise from the implementation of EMIR: since clearing members and clearing houses currently require Variation Margin (VM) collateral to be posted in cash only, liquidity needs may go up in times of stress. This is likely to be exactly the time when it is difficult to obtain liquidity, which may contribute to liquidity freezes and fire-sales of other assets, causing destabilizing price spirals. Central banks providing lending directly to end users such as pension funds may mitigate these effects.

Q9-Q15: No comment

Q16. *In your view, what are the relevant information/data items authorities should monitor for financial stability purposes in relation to indemnifications provided by agent lenders/asset managers to clients in relation to their securities lending activities?*

Answer:

The relevant information would be the total amount of indemnification-related exposure that agent lenders have to their clients. Examples in this case are information on the diversification of collateral and collateral valuation methodologies. Furthermore we would like to stress that under the European Market Infrastructure Regulation (EMIR) and the Securities Financing Transactions Regulation (SFTR) lots of relevant information already is gathered.

Q17. *Should the proposed recommendation be modified in any way to address residual risks related to indemnifications? For example, should it be more specific with respect to actions to be taken by authorities (e.g. identifying specific means for covering potential credit losses) or more general (e.g. leaving to authorities to determine the nature of appropriate action rather than specifying coverage of potential credit losses)?*

Answer:

Additions to indemnification-related exposure:

- *Proposal 1*: All indemnification-related exposure of agent lenders/asset managers to clients could be made available to asset managers by making use of the trade repositories. These are already used for EMIR-related purposes of collecting data on derivatives transactions (Over-the-counter, cleared and exchange traded). Currently, only supranational supervisory authorities such as ESMA have access to the data of the trade repositories.

- *Proposal 2*: As a next step, all market participants could be allowed access to the data of the trade repositories. The information contained in these data can be used for two purposes:
  - In the due diligence process for selecting an asset manager (e.g. as a check on the administrative organisation and internal control system)
  - In the process of monitoring the activities of the asset manager.

Additions to securities lending and repo-activities by pension funds

- With regard to securities lending, if a Global Master Securities Lending Agreement (GMSLA) is used and the rules for securities financing transactions resulting from Mifid's implementing measures are followed, we do not see serious issues.

- In contrast to securities lending, we see an increasing need for pension funds to use repurchase agreements (repos), the reverse transaction of securities lending. The effects of

EMIR, where Clearing Members require market participants including pension funds to post Variation Margin (VM) for derivatives transactions in cash only, force pension funds to increasingly use repos (subject to national legislation, in the Dutch case: the repo must have a maturity of less than 1 year and be used for liquidity purposes only). This may be an issue because pension funds are likely to need liquidity from repo transactions in stressed market conditions, which is exactly when counterparties may not be willing (or only against excessive costs) to lend cash, which may cause further market distortions.

- A workable solution could be to enforce that clearing members and central clearing parties allow highly liquid and high grade (government) bonds to be posted as collateral. This would drastically decrease liquidity needs of pension funds, and prevent liquidity freezes in stressed conditions. A second solution, as outlined above, could be to allow direct access to central bank lending in times of liquidity stress, which would provide a guarantee of liquidity in stressed circumstances to end users.

- Finally, we propose to consider allowing an (undisclosed) right of lien on securities where the borrowing party has a right of use. This provides additional protection to the lending party, which may keep the securities lending and repo market accessible even in stressed times. This requires adjustment and realignment of the Settlement Finality Directive and national insolvency legislation. This could be taken up as part of the Capital Markets Union initiative looking at the effects of national insolvency legislation on (foreign) direct lending.