APG Memorandum on the Impact of a European FTT

TUAC/ITUC Response

Paris, 1 December 2011

On 31st October 2011, APG, a leading European asset manager that provides services to Dutch pension funds (EUR285bn AUM), issued a Memorandum on the impact of a Financial Transaction Tax (FTT) as recently proposed by the European Commission (EC)[1]. The Memorandum (see Annex) states that "current and future retiree[s] simply cannot afford to bear the additional costs that the FTT" would bring, that such taxation would "unfairly hammer their pension returns" and that it would "massively penalize the second pillar pension system of The Netherlands". The memorandum states in rather blunt terms APG's opposition to the FTT: "The retirement savings of many millions of European citizens simply should not become a new cash cow of Brussels. Pension funds should not be used to raise money to help bail out the struggling economies or banks".

The Trade Union Advisory Committee to the OECD (TUAC) and the International Trade Union Confederation (ITUC) support the creation of an FTT. At the same time, the TUAC, the ITUC and their affiliated national confederations are attentive to the views of the pension fund industry and their asset managers. While trade unions primarily represent the interests of workers as employees, they are also, in many countries investors through their long term savings in pension schemes. Trade unions support sustainable and responsible investment policies by pension funds that ensure workers' right to decent, adequate, secured and predictable retirement pensions. At the international level, trade unions engage with pension funds and pension fund trustees via the Global Unions' Committee on Workers' Capital[2].

The aim of an FTT is to curb short-term financial speculation and provide vital sources of government revenue. It is important that the cost of the FTT is not be borne by working families, including retirees and that any FTT be designed or accompanied by regulatory measures that mitigate the impact on workers' pension rights and on retirees' pensions. This could be ensured through *ex-ante* impact assessment studies to shape the initial design of the FTT. However, given the lack of statistical information on pension funds' portfolio composition on a global, OECD or EU-wide scale, the potential of this approach is limited. Accordingly ex ante impact assessments would be usefully complemented by *ex-post* periodic reviews in the implementation phase of an FTT.

We disagree with the views expressed by APG in its memorandum. In our view a carefully designed tax – in the range that the EC is proposing – would make sense. We set out our response to APG's key arguments against the FTT.

[1] Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC {COM(2011) 594} {SEC(2011) 1102}

[2] www.workerscapital.org

APG statement a) “The FTT would adversely affect the returns on pension funds investments”. *APG claims that an FTT would “make pension investments very costly” because pension funds would be “directly hit at least twice by the FTT: when the fund manager arranges a transaction on behalf of the fund and when the fund acquires or sells that asset”.*

As regards APG’s first concern regarding the impact of the FTT on cost what matters is the holding period. The cost is disproportionately high for short term trades (buying and selling a security every hour, every trading day over a year), marginal for medium term trades (buying and holding a share over a 1-year period) and becomes negligible for long term trades (buying and holding a 10-year bond until maturity). Pension funds are long term investors given their liability profile. Unlike banks they face very little short term liquidity pressures and are important owners of long term securities such as bonds. Compared to other investors, pension funds are assumed to have longer holding period policies and hence to be comparatively less exposed to the cost of an FTT.

Turning to APG’s second concern that a pension fund would be “hit twice” by the FTT, we consider that APG has over-stated the significance of this issue and failed to take account of all the necessary factors:

- APG seems to assume that pension funds externalise 100% of their portfolio management to asset managers. In reality many pension funds – including the larger ones – internalise portfolio management. In that case they are only ‘hit’ once.

- Even in cases where pension funds do externalise their port management, a pension fund makes a one-time transaction to the asset manager (when the pension fund attributes the investment mandate to the asset manager). Mandates span over a year, if not several years. As the holding period is long, the cost of external management on the pension fund side is therefore marginal.

- On the asset manager’s side, as noted above, the cost of the FTT will be proportional to the holding period within each asset class. The cost will be high for short term equity and bond trading – particularly hedge funds and “High Frequency Trading”. At the other end of the spectrum, the cost will be close to zero for private equity funds (which invest in unlisted equity, each transactions spanning over three or more years).

- APG assumes that 100% of the cost of the FTT borne by external management will be transferred to the pension funds. This does not take account of competition in the market place and the fact that asset managers may seek to internalise at least part of the cost of the FTT for fear of losing their clients.

APG statement b) “Pension funds are no financial institutions in the common sense of the word”. *APG claims that “pension funds are not speculating investors and should not be compared to financial institutions such as banks and hedge funds”, that they are “independent and not-for-profit organizations” which have a “social function”.*

We could not agree more. However the social function of pension funds has already been recognised in the EU Green Paper on Pensions and across OECD jurisdictions by way of significant tax exemptions on contributions by employers and employees, on capital gains by pension funds and/or on pension benefits by retirees. It is also because of that social function that several OECD jurisdictions grant government guarantee schemes to pension funds[3] (with the notable exception of the Netherlands, see below). These government guarantees do not come free. They are treated as 'contingent liabilities' on governments' balance sheet and are factored in their sovereign ratings[4].

The impact of an FTT on pension funds should be considered within the context of significant and legitimate direct tax exemptions as well indirect exemptions (via VAT exemptions benefiting the asset management industry). If needed these tax exemptions could be adjusted so as to protect pension plan members' retirement income and rights. Also, given that the revenue of the FTT would go the government budget, it would, indirectly, help strengthen pension-related government guarantees where they exist.

APG Statement c) "Pension funds are not the cause of the financial crisis nor can they create systemic risks". *APG claims that "theoretical risk of bankruptcy of pension funds is extremely limited" and accordingly "the risks that pension funds represent are very limited, or even non-existent". APG further claims that, in case of under-funding "pension funds can mitigate this risk by (i) increasing the premiums, (ii) (temporarily) stopping the indexation of pensions, (iii) decreasing payments to the pensioners or (iv) extending the retirement age".*

While pension funds themselves were not the cause of the financial crisis, pension money was used (with or without the knowledge of pension trustees) to fuel and indeed expand high speculative trading strategies and investment products.

Pension funds do not face short term liquidity pressures on the same level than banks. There is no risk of a "run" on a pension fund as there is on a bank. However underfunding – i.e. a mismatch between assets and liabilities – still remain of concern across OECD economies, and has been highlighted by the OECD and other international organisations. When that happens, APG claims that risk sharing arrangements are triggered between employers, employees and retirees. As regards the solutions proposed by APG:

- increasing the premiums puts the burden on employers and employees;
- temporarily stopping the indexation of pensions puts the burden on retirees and on employees who are close to retirement;
- decreasing payments to the pensioners puts the burden on retirees;
- extending the retirement age puts the burden on employees.

Such risk sharing arrangements are indeed in place in the Netherlands. But that is far from being the norm across Europe and the OECD economies at large. As noted above, in case of severe underfunding several jurisdictions have government guarantee schemes. When this happens the pension funding solvency risk is partly transferred to the government.

APG Statement d) "Current and future retirees have already paid their share for mitigating the effects of risk taken by commercial risk taking market participants". *APG claims that "pension funds are large investors on financial markets and heavy users of derivatives to hedge pension liabilities, they would have to bear a very large part of the total taxes". Based*

[3] See: Stewart, F. (2007), "Benefit Security Pension Fund Guarantee Schemes", OECD Working Papers on Insurance and Private Pensions, No. 5, OECD Publishing. http://www.oecd.org/dataoecd/38/63/37977335.pdf

[4] See: page 19, figure 4 in Kim & Schich (2011), "Guarantee Arrangements for Financial Promises: How Widely Should the Safety Net be Cast?", Sebastian Schich & Byoung-Hwan Kim, OECD Journal: Financial Market Trends, Volume 2011 – Issue 1, January 2011 http://www.oecd.org/dataoecd/42/49/48297609.pdf

on a "rough calculation", APG claims that the creation of an FTT would see Dutch pension funds "pay 3 billion euro per year, which equals approximately 6% of the total taxes (57 billion euro) that the European Commission aims to collect". APG also states that the "Swedish experiences in the recent past, in the aftermath of their banking crisis, showed that the introduction of a transaction tax is ineffective".

Pension funds are indeed key investors in the USD+450tr over the counter (OTC) interest related derivatives market. As argued above, however, what matters is the holding period. Derivatives are insurance schemes. Pension funds buy them and then hold them until maturity, which can span over several years[5]. Accordingly the impact of an FTT on OTC derivatives should be assumed to be comparatively marginal. The EC has proposed to apply a tax rate of only 0.01% on derivative products. It should also be noted that the OECD Secretariat supports the creation of an FTT on OTC derivatives[6].

We would be interested to know more about the methodology used for the "rough calculation" made by APG. As noted above, we believe that there are certain limitations to what can be achieved in the field of *ex ante* impact assessment. Neither the OECD, the ECB, nor Eurostat have sufficiently detailed data on pension funds' portfolio composition (beyond broad asset class division: bond, equity, mutual funds, cash, "alternatives"). The EC concedes that its own impact assessment "should be interpreted with caution given certain limitations of the underlying models", which "could overestimate the negative GDP effects of the tax"[7]. We believe that *ex-post* periodic reviews in the implementation phase of the FTT would go a long way in mitigating any unintended negative impact on workers' rights to decent, adequate and secured pensions.

Finally, the failure of the Swedish FTT in the 1990is is mentioned by opponents of the FTT recurrently. We do not think that it is appropriate to compare this with the EU or Eurozone-wide FTT. The Swedish FTT failed because it was badly designed, not because it was an FTT *per se* [8].

[5] According to BIS statistics, of the USD394tr worth OTC single-currency interest rate derivatives held by investors excluding large banks (in BIS terms, that is "All counterparties" minus "Reporting dealers), 55% had a maturity above 1 year, and 24% had a maturity above 5 years. Source: http://www.bis.org/statistics/otcder/dt21c22a.pdf

[6] See e.g. page 61 , report on a G20 Workshop "The New Financial Landscape", available at http://www.oecd.org/dataoecd/14/49/48501035.pdf

[7] Commission Staff Working Paper – Executive Summary of the Impact Assessment Accompanying the document Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC.

[8] See p 158 & 173 in "Financial Sector Taxation: The IMF's Report to the G-20 and Background Material", Stijn Claessens, Michael Keen, and Ceyla Pazarbasioglu, International Monetary Fund, September 2010.

APG Memorandum

To	Whom it may concern	**Amsterdam,** October 31st, 2011	
From	APG		

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Subject: Financial Transaction Tax

We would like to inform you of our position regarding the European Commission proposals for the Financial Transaction Tax (FTT). With a view to the forthcoming political debates in the European Parliament and the Council, we would like to draw your attention to the impact that the FTT will have on the pensions of many millions of European citizens.

Please be informed that APG Algemene Pensioen Groep NV (hereinafter: APG) is one of the world's largest administrators of group pension schemes and administers the pensions of over 4 million pension participants in the Netherlands. APG exclusively provides services to pension funds (and pension funds only). APG manages pension assets of approximately 285 billion euros for pension funds through a variety of equity, fixed income, cash management, alternative investment and real estate.

We do understand some of the underlying reasons for introducing a FTT. We certainly agree with the European Commission's aim to create incentives for long-term investment, but we do not believe that the FTT is the appropriate measure to do so. As currently framed, the proposals for the FTT will disproportionately impact pension funds and therefore many millions EU taxpayers and pensioners. We simply **cannot** agree with the introduction of the FTT for the following reasons.

a. The FTT would adversely affect the returns on pension funds investments
Even though the FTT, at prima facie, is intended to only have implications for financial institutions, it would also have an economic impact on pension savings. It would have an impact on pension funds in their capacity as counterparties of banks, and because the FTT would be directly imposed to pension funds, their dedicated investment funds and their asset managers. This will make pension investments very costly. As currently framed, pension funds could be directly hit at least twice by the FTT: when the fund manager arranges a transaction on behalf of the fund and when the fund acquires or sells that asset. If enacted, the FTT would reduce retirement income, at a time when pensions are already under considerable stress. Current and future retiree simply cannot afford to bear the additional costs that the FTT would pass on to them. The FTT would unfairly hammer their pension returns and would massively penalize the second pillar pension system of The Netherlands. We are surprised that the European Union on one hand aims to promote more funded and private pensions through the workplace and strengthen the internal market for pensions in order to increase cost efficiency in funded pension savings management, but on the other hand

suggests a broad range of proposals (AIFMD, CRD IV, MIFID and the FTT) that undermine the cost efficiency in funded pension savings managements.

b. Pension funds are no financial institutions in the common sense of the word
The introduction of a FTT, to curb speculative trading, is as such legitimate, but it should be noted that pension funds are no speculating investors and should not be compared to financial institutions such as banks and hedge funds. Yes, pension funds are financial markets participants, but they are creditworthy, conservative, stable, long-term and non-commercial investors on financial markets. They operate as foundations which are independent and not-for-profit organisations that are controlled by employee and employers organisations. They are not part of any company and do not have shareholders. Therefore they do not incur marketing costs or have to comply with investors' demand for a specific return on equity (pay dividend). The social function of pension funds should be taken into account and they should not be qualified as financial institutions in the same sentence as commercial and risk taking financial institutions such as banks or hedge funds.

c. Pension funds are not the cause of the financial crisis nor can they create systemic risks
The theoretical risk of bankruptcy of pension funds is extremely limited. Pension funds can mitigate this risk by (i) increasing the premiums, (ii) (temporarily) stopping the indexation of pensions, (iii) decreasing payments to the pensioners or (iv)extending the retirement age. There is thus no valid argument why pension funds should be penalised by imposing them to the FTT, as the risks that pension funds represent are very limited, or even non-existent. It should also be noted that pension funds, and therefore many millions of EU citizens who are saving for their retirement, have also suffered losses, because of the financial crisis. The funding ratio of pillar II defined benefit pensions have been hit by declining asset prices and increasing liabilities.

d. Current and future retirees have already paid their share for mitigating the effects of risk taken by commercial risk taking market participants
The FTT would have the effect of making the saving for retirement purposes very unattractive. Because European pension funds are large investors on financial markets and heavy users of derivatives to hedge pension liabilities, they would have to bear a very large part of the total taxes. We have calculated that the FTT would have a negative impact on pension beneficiaries, resulting in the lowering of pension incomes. Our rough calculation showed that the Dutch pension funds sector would have to pay 3 billion euro per year, which equals approximately 6% of the total taxes (57 billion euro) that the European Commission aims to collect. This is disproportional and unfair. It should be noted that small differences in return on long term savings make huge differences in final pension outcome. It should be clear that those taxes would have to be paid by current and future retirees, the interest of which the introduction of FTT aims to protect. We do not see any valid reason why current and future retirees should pay such a large part of the total to be collected taxes for mitigating the effects of the financial crisis. They have already paid for the bail outs of financial institutions in their capacity of citizens of EU member states. They have already suffered losses because of the crisis. The retirement savings of many millions of European citizens simply should not become a new cash cow of Brussels. Pension funds should not be used to raise money to help bail out the struggling economies or banks. The Swedish experiences in the recent past, in the aftermath of their banking crisis, showed that the introduction of a transaction tax is ineffective.

CONCLUSION: The FTT would hit ordinary pension savers very hard and would result in pensioners paying for the FTT through reductions in the value of their pensions. Pension savers and investors could end up shouldering an unfair share of the burden of the FTT. As proposed, this would be a tax on current and future retirees and on savers. We therefore strongly would like to recommend European policymakers to closely consider the impact of the FTT on European pension funds. It is imperative that an impact assessment of the FTT on pension funds is carried out to be able to justify the imposition of the FTT.

We are prepared to provide our expertise in this matter and to cooperate with the European institutions to find solutions. Should you have further questions or like additional clarifications please do not hesitate to contact us.

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