Euro area summary of the Merits and Costs Procedure (MCP[1]) for the European Central Bank (ECB) Regulation on Pension Fund statistics

The European Central Bank (ECB) is currently compiling pension fund statistics using a "short-term approach", i.e. using data available today with no harmonisation within the European Union (EU). To achieve higher data comparability and meet new user requirements, the ECB launched preparations for the creation of an ECB Regulation aiming to harmonise data collected on pension funds and thus obtain more information about the activities of this sub-sector. On 4 October 2016 the Governing Council decided to increase transparency on developing ECB Regulations on European statistics in line with the proposals made in the MCP, therefore the ECB will publish an overall summary of the results for the euro area of each MCP.

Background

The euro area pension fund sector has around 50 million members. Pension funds are among the largest and fastest growing investors in global capital markets. In spite of the financial crisis, euro area pension funds have almost doubled their size since 2008. Currently their total assets account for around €2.5 trillion. In order to increase the transparency of pension funds for the benefit of their members, the general public and the economy as a whole, the ECB is introducing a new ECB Regulation on pension fund statistics.

Pension funds play a dual role, helping individuals save for old age and allocating long-term capital efficiently across firms and sectors, which helps ensure innovation and growth. The financial crisis, the low interest rate environment and the ageing population in Europe all highlight the need for higher quality, more granular and comparable data on the sector. For the pension fund sector, harmonised and comparable data are hard to collect. This is because of the many different types of pension funds and because their characteristics vary across countries. The current gaps in the data available make it difficult to achieve a comprehensive understanding of the cash flows and the risks associated with pension obligations

1 See: "The ECB's merits and costs procedure in the field of European statistics".

1 Summary of the fact-finding exercise

In 2015, the Statistics Committee (STC) of the European System of Central Banks (ESCB) asked the Working Group on Monetary and Financial Statistics (WGMFS) to launch an MCP for pension fund (PF) statistics. As a follow-up, the WGMFS agreed on the creation of a Task Force on PF statistics (TFPF) composed of experts reflecting the different national characteristics across countries[2]. During the fact-finding, the following issues were noted:

- **Reporting population:** Given the large population of PF and its skewed distribution across countries, such that proportionality matters greatly, a trade-off is necessary in particular between the reporting burden and statistical coverage. The composition of the sector follows a similar pattern in most countries, with few large undertakings, a high number of small institutions and a sizeable number of medium-sized entities; in addition the sectoral delineation and definitions were also needed before the cost assessment questionnaire could be addressed to the reporting agents.

  In the fact-finding questionnaire it was noted that an increase in the coverage of the market measured in terms of total assets from 80%/85% up to 95% would almost double the number of reporting agents.

- **Timeliness:** Most countries were able to report quarterly assets with good coverage and the WGMFS decided to include a question on timeliness for reporting quarterly assets/liabilities in the draft cost assessment questionnaire. One of the conclusions of the fact-finding exercise was that the quarterly reporting of liabilities by pension funds could be one of the major difficulties.

- **"Defined benefit" and "defined contribution" pension plans:** According to current national laws and markets, in some countries pension funds only offer pension plans classified as "defined benefit" plans while in others only "defined contribution" pension plans are in place. One special feature of some pension systems is the parallel existence of pay-as-you-go schemes and funded schemes. In fact, they can both be offered by one pension fund at the same time.

- **Split by sector according to the European System of Accounts (ESA2010):** The statistical classifications included in the ESA 2010 are completely new for PFs and therefore imply fundamental technical challenges for this reporting sector. As additional fields in the core database would have to be introduced this would, as a consequence, imply high set-up costs.

- **Provision of information on pension entitlements broken down geographically by counterpart:** PFs may not have information about changes in residency of their members.

[2] The TFPF was composed of experts on pension funds from the national central banks (NCBs), the national supervisory authorities (NSAs), the European Insurance and Occupational Pensions Authority (EIOPA), the Organisation for Economic Co-operation and Development (OECD), and the European Commission (Eurostat).

The outcome of the fact-finding exercise was a key element used in the drafting of the costs assessment questionnaire which was addressed to the national central banks (NCBs), national supervisory authorities (NSAs) and reporting agents (pension fund associations, pension funds and pension fund managers, as necessary).

2 The ECB's interaction with reporting agents and supervisory authorities

The pension fund industry was involved in the development of the proposal for the matching of merits and costs. First, at the national level, for the participation in the costs questionnaire the NCBs contacted either the principal national associations of pension funds in the corresponding country or the NSA. These institutions in turn were also invited to share the cost assessment questionnaire with their members and supervised entities respectively. Some NCBs also contacted a sample of key reporting agents. Second, the WGMFS also organised some meetings[3] with main stakeholders (e.g. Pensions Europe) where the possible handling of costly features[4] was discussed with industry representatives. This led to a better understanding of the structure of the questionnaire and served as an introduction to the statistical classifications according to the European System of Accounts (ESA 2010). EIOPA representatives supported the whole process towards an ECB Regulation on PF statistics. The WGMFS also discussed coverage and access to future data, especially in the case of PF that will not be covered under the Institutions for Occupational Retirement Provision Directive II (IORP II). Finally, the WGMFS held another meeting with the pension funds industry and EIOPA on 29 May 2017 shortly before launching the public consultation.

3 Assessment of costs and benefits

The matching of merits and costs regarding the collection of balance sheet statistics on PFs was the last step before drafting the ECB Regulation on pension fund statistics. On the basis of the cost assessment carried out by NCBs – in liaison with the potential reporting population – and the merits assessment[5] provided, a proposal for the final reporting scheme was elaborated.

During the **cost assessment**, despite the very heterogeneous situation in the euro area PF sector, the main cost drivers were similar across countries. The aspects identified by the reporting agents as the most expensive were:

- **Small pension funds:** For small pension funds the costs of reporting would be very high. Many reporting agents asked for consideration to be given to

[3] On 4 April 2016 and on 19 September 2016.

[4] Pensions Europe provided a reply on the cost assessment questionnaire on 30 May 2016.

[5] Merits provided by user committees (the Monetary Policy Committee, the Financial Stability Committee and the European Systemic Risk Board), the European Commission (Eurostat), EIOPA and the STC Working Groups.

differences between capital-based and pay-as-you-go schemes. Conversely, in a few countries it was mentioned that all PFs are required to send the same data and therefore the cost of increasing the coverage would be negligible.

- **Quarterly reporting of liabilities** was reported by all countries as a fundamental cost driver and in most cases was not considered feasible.
- **Loan-by-loan reporting** was assessed as involving significantly higher costs. With regard to mortgage loans in particular this item was identified as being either not applicable or not feasible in most countries;
- **Security-by-security reporting** seemed to be less costly, especially for large PFs, however, it could be a costly item for many small and medium-sized PFs in a few countries.
- **Transactions/revaluations:** The reporting of transactions or revaluations would therefore involve fundamental changes at all levels which are deemed to be very costly.
- **Market valuation of liabilities:** Many PFs indicated that a market valuation of liabilities is not yet carried out and would entail high costs and a delay in timeliness.

Remarkably, in most cases set-up costs were estimated to be significantly higher than running costs. Internal IT systems are often not designed for supervisory or statistical reporting and would in many cases have to be adjusted or rebuilt. Furthermore, the classification of sectors according to the ESA 2010 differs from the current supervisory reporting, which could give rise to additional costs.

Regarding the **merits** assessment, the users welcomed the improvements in the availability, quality and consistency of PF data implied by the issuance of an ECB Regulation on PF balance sheets. The user committees and the European Commission welcomed the prospect of minimising the reporting burden for the industry by accepting some quarterly estimates, especially on the provision of liabilities (e.g. pension entitlements). The following general issues were also raised:

- **Reporting population:** The users agreed with coverage of 85% of total assets and to applying a threshold of 80% for large populations of small pension funds to ensure sufficient coverage and limit the costs.
- **Timeliness – quarterly reporting of assets and reporting of annual liabilities by pension funds and quarterly estimates by NCBs:** In the replies received there was a general consensus supporting the quarterly reporting of assets, while it was considered acceptable for pension funds to report liabilities on an annual basis and for quarterly estimates to be derived by NCBs.
- **Granularity and security-by-security reporting:** Overall all the replies received stressed the importance of the security-by-security reporting by PFs.
- **Transactions:** The users stressed the importance of having data on transactions.

- **Individual country counterpart data:** The individual European country dimension was considered crucial and users supported providing a more granular European and major rest of the world country-specific breakdown that would add value for the analytical work, in addition to the general geographical breakdown (domestic, euro area and rest of the world).

- **Loans on an aggregated basis but to be reconsidered at a later date:** All users agreed that given the size and the costs, loan-by-loan reporting could be disregarded given that aggregated reporting is acceptable. Nevertheless, the users stressed that this could be reconsidered in the future if the involvement of PFs in lending activities increases significantly and gains economic relevance.

- **Investment fund by investment strategy:** The user committees welcomed and ascribed high merits to the inclusion of investment funds broken down by investment asset classes e.g. bond funds, equity funds, mixed funds, real estate funds, hedge funds and other funds).

- **Pension fund entitlements – breakdown into defined contribution, defined benefit and hybrid schemes:** The user committees ascribed high merits to the inclusion of a **breakdown** of the pension entitlements by type of plan (e.g. defined contribution, defined benefit and hybrid schemes). EIOPA stressed its interest in having a breakdown in the assets for debt securities, investment funds and equity between defined contribution (DC), defined benefit (DB) and hybrid (HB) schemes[6]. In the discussion many countries argued that it is not possible to prepare such a breakdown of the assets. This feature therefore was abandoned.

- **Alignment with international statistical standards (ESA 2010/BPM6) and other statistics/datasets (Securities Holdings Statistics (SHS), Centralised Securities Database (CSDB), financial accounts, OECD, etc.):** All the replies welcomed the alignment of the requirements for PFs with international statistical standards for harmonisation, compilation and comparability purposes.

Against this background, the matching of merits and costs, which was approved by the STC in March 2017: (1) presented the outcome of the matching of merits and costs, i.e. it considered the essential needs of the users in the light of the outcome of the cost assessment and (2) put forward specific proposals for the PF reporting requirements that were included in the draft ECB Regulation on pension fund statistics.

[6] In the ESA 2010 in paragraph 17.59 it is suggested that notional defined contribution schemes and hybrid schemes are grouped as defined benefit schemes. A notional defined contribution scheme is similar to a defined contribution scheme but with a guaranteed minimum amount payable. Hybrid schemes are those schemes which have both a defined benefit and a defined contribution element. A scheme is classified as “hybrid” either because both defined benefit and defined contribution provisions are present or because it embodies a notional defined contribution scheme and, at the same time, a defined benefit or defined contribution provision.

Other relevant information

Market participants would benefit from EU-wide guidelines on sectoral classification instead of each NCB potentially using different ones. Some institutions have embraced a recognised market classification, like classification of economic activities in the European Community (NACE), which is preferable. Also, the use of the Legal Entity Identifier (LEI) code was proposed by some pension funds to help them identify issuers of loans.