Speech

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CREATING LASTING VALUE

Speech given by Dörte Höppner on 1 March 2012 at a European Commission hearing about the revision of the Institutes for Occupational Retirement Provision (IORP) Directive.

Good morning.

First I would like to start by thanking the European Commission for extending me and the European Private Equity and Venture Capital industry the invitation to participate today. Pension funds are major investors in the asset class private equity and venture capital. We put this money to work in the real economy to deliver returns to pension funds and their beneficiaries. Imposing Solvency II rules on pension funds could put all of this at risk.
The European Private Equity and Venture Capital Association represents over 1, 200 member companies which provide equity financing and business support to over 24, 000 European companies.

Over 85% of all private equity investments are in small to medium sized enterprises, that's about 22, 000 companies. Now this may sound a lot, but given there are more than 20 million SMEs in Europe, it is a relatively small number so I think it's worth spending a moment to understand what makes these companies different:

Private equity and venture capital funds are the talent scouts of company investment. They spend an enormous amount of time assessing the potential of companies, to understand risk - and of course how to manage it.

Once a private equity fund manager invests in a company, either through majority or minority stakes, they are then active and responsible owners working in partnership with company managers.

A recent study by the Technical University of Munich shows that private equity backed SMEs, on average, had an annual growth rate of 7% over a four year period. For European SMEs in general this is around 2%. A private equity fund, on average, maintains ownership of a company for five years. Institutional investors on average, maintain positions in public equity for one year or less. So private equity helps companies grow. It helps economies grow. And this helps pension pots grow.

This may help to explain why - over the last four years - pension funds accounted for over one third of all investments in European venture capital and private equity. That's over 50 billion euros of investment, via private equity, for European companies, and again - 85% of these companies are SMEs. Pension funds play a key role as global providers of long term capital.

I am sure you have heard - and will hear again today - many good reasons why applying capital adequacy based regulation to pension funds will not work.

But I think it's worth reminding ourselves:

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One is the increased cost of pension schemes. If pension funds covered by the IORP Directive had to comply with Solvency II they would be required to hold extra assets of close to 1000 billion euros.

This capital has to come from somewhere and be at the expense of something or someone.
In this case it would of course come from the companies sponsoring the pension plan and be at the expense of the same companies' working capital.
This is capital that could be spent on financing Research & Development or plant or machinery – in short growing the business. It would also hit the employees where it hurts the most – their pocket. This is surely not a way to encourage companies to grow or Europe's increasingly pressed citizens to save for the future.

The European Commission wants to create a level playing field for pension schemes and insurance products. But these aren't competing teams playing on the same pitch that is somehow uneven – they are different sports – played on different pitches - so the same rules should not apply.

Pension schemes are generally not for profit, they don't compete with each other, there are mechanisms to adjust contributions or benefits over time if needed. They often have a collective character supported by a collective agreement which is negotiated by employer and employee representatives.
Pension funds don't need the same short term cushion as say banks or even insurance products. Their liabilities are predictable and held far into the future.
It's not like we are all suddenly going to retire tomorrow.
As a long-term investment strategy - private equity and venture capital is perfectly suited to the long-term liability profile of pension schemes. Defined benefit schemes in particular invest, through private equity, over a long-term horizon in the real economy. This stable source of capital is used to grow real companies which then deliver a return back to the pension fund, and ultimately the beneficiaries.

This is why the market approach to valuation, as advised by EIOPA, is particularly unsuited to the illiquid nature of long-term asset classes such as private equity or infrastructure.
The Bank of International Settlements envisages that Solvency II rules will shift investment from companies and long-term capital projects to fixed income products such as bonds.
In this low-interest, low-growth environment it would also reduce the potential for pension plans to match their liabilities as they fall due.
Should pension funds be forced to adopt less diversified investment strategies it could also increase their own risk profile.

The shift away from long-term asset classes will increase systemic risks in the financial markets. So far, pension funds do play a stabilizing role. This should not be changed.
We recognise that in the wake of the financial crisis that legislators and regulators will seek ways to prevent this ever happening again. The establishment of the new European supervisory bodies, for example, is certainly a positive contribution. And of course regulation per se is not a bad thing, quite the contrary. However it must be proportionate, balanced and appropriate.

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We recognise that private equity and venture capital is not the focus of this review, but we, or more to the point the companies in which we invest, are a good example of the unintended consequences inappropriate regulation could have. The pension funds must continue to play the very important macro-economic role as global providers of long-term investment capital. Europe needs growth. And in order to grow companies need capital. We should not put this at risk.

This is why we believe there should be a thorough assessment of the full macro-economic impact of this proposed legislation.

Thank you for your attention.

Dörte Höppner,

EVCA Secretary-General