APG Response to the European Commission Green paper "Feasibility of introducing Stability Bonds"

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APG welcomes the Green paper "Feasibility of introducing Stability Bonds" of the European Commission. The common issuance of stability bonds might have significant potential benefits for the entire European economy. We are pleased that the European Commission acknowledges that the success of stability bonds will be dependent on fiscal integration and implementation challenges. Stability bonds could be a next step after a substantially reinforced fiscal surveillance and policy coordination in the EU. The "Six Pack" agreement and the forthcoming intergouvernemental agreement are essential requirements on economic governance for a successful introduction of stability bonds. Because of the potentially economic, political and financial consequences of the introduction of stability bonds. APG pleads for a more detailed consideration and analysis, including an impact assessment. APG is willing to share its expertise with the European Commission.

Stability bonds have potential benefits

The introduction of commonly issued stability bonds would mean a pooling of sovereign issuance among the Member States and the sharing of associated revenue flows and debt-servicing costs. This would significantly alter the structure of the euro-area sovereign bond market. APG agrees that stability bond issuance would offer the possibility of a large and highly liquid market for safe assets, with a single benchmark yield in contrast to the current situation of many country-specific benchmarks. Furthermore, the introduction of stability bonds could lead to lower financing costs for both the public sector and the private sector in the euro-area and thereby reinforce the longer-term growth potential of the economy. So, stability bonds could be beneficial for the entire European economy. In the short term, stability bonds could cut the positive feedback loop when a Member State loses market trust and relieve the current crisis in the sovereign debt market. This could result in more financial stability, lower interest rates in Member States without a AAA-rating, but also in a decrease of the interest rates of "safe havens".

Liquid and stable bonds could be useful instruments for pension funds and pension funds will benefit from higher economic growth due to the lower financing costs for the private and public sector. However, lower interest rates will imply lower returns for pension funds. Lower interest rates could have a negative impact on pension funds when they have to discount their liabilities with this interest rate.

Implementation is complex and crucial
Whether stability bonds would provide financial stability and economic efficiency fully depends on *how* these stability bonds will be introduced. As the European Commission mentioned, a sufficiently robust framework for budgetary discipline and economic competitiveness at the national level and a more intrusive control of national budgetary policies by the EU would be required. Without these commitments, the loosening of incentives caused by stability bonds will undermine the confidence in repayment, and thus the liquidity and stability of the market. We are pleased that the European Commission acknowledges that a reinforced fiscal surveillance and an appropriate implementation will be crucial. The Green paper goes into detail on implementation issues like the organizational set-up, the legal regime, market conventions and accounting issues. APG is of the opinion that it is very important that *all* implementation details are accomplished and agreed upon by the time the scheme gets proposed.

As a potential buyer of stability bonds, APG would like to point out that financial markets expect a transparent relation between risk and return. With their long history of trading sovereign bonds, markets are used to (and have ways to) assess the risk of national bonds. With the introduction of stability bonds, markets would have to assess the risk inherent in a joint bond. That is the stacked risk of many things: the collective holding together, and all the cases in which a single Member State would become delinquent and what that would mean for the common bond. Especially with joint and several guarantees (Approach 1), the relation between risk and return becomes less transparent. This argues for maximum simplicity and transparency in the design of the bonds:

- First of all, the default mechanism should be clear, both for debt that falls outside the main, jointly guaranteed, supply and for the stability bonds themselves.
- Another essential element for institutional investors is predictability. When political decisions can change the conditions of the stability bonds along the way, this will reduce the willingness to invest in the new bond. The European Commission should take this into account and rule out political interference from the start. This includes direct interference (*e.g.*, politicians deciding who has access to the pool) as well as basing decisions on parameters that are easily influenced, or delivered exclusively by national sources.

Impact assessments required
Currently, institutional investors have the option of diversifying their investments among different European Member States. Pension funds are traditionally looking for opportunities to diversify in order to reduce their risks. With stability bonds Approach 1, the option to diversify disappears and the whole financial sector in Europe is exposed to one instrument. This concentration of risk in a very systemically important asset makes it crucial to work out all the details and implications in advance. It is of the utmost importance that the in-depth impact analyses of the introduction of stability bonds include the possible consequences on the European economy and the financial sector.

Another important question is what the status of the outstanding bonds will be relative to stability bonds. If the currently outstanding bonds become junior to the

jointly issued bonds, this will increase their risk and the yields on the outstanding bonds will increase. This means that the current holders, for example pension funds and their members and beneficiaries, will pay the price of the introduction of stability bonds. On the other hand, the odds of a default go down if this plan is accepted, as it would likely calm markets and give countries a source of financing to pay off the old bonds. An impact assessment is needed to quantify these effects.

Other instruments
The Green paper argues for stability bonds as an instrument which also could also be beneficial as a way to alleviate the tensions in the sovereign debt market. However, stability bonds are not the only potential instrument in order to solve the current problems. Therefore alternative solutions - and the relation between different solutions - to the problems facing the sovereign bond market should be discussed, including the role of the ECB and the debt redemption fund proposal. The introduction of stability bonds may not be sufficient to deal with the problems of some Member States where restructuring may be necessary. It is important to get these considerations out of the way before introducing joint issuance.

APG is willing to support the Commission
APG acknowledges the great challenges to improve the long-term sustainability of the European economy and to alleviate tensions in the sovereign debt market in the short run. Stability bonds could contribute to these goals and might have some significant benefits. However, the introduction of these bonds requires careful consideration. Binding political decisions are necessary, as well as the organizational and legal groundwork and a new set of market conventions. A botched introduction of stability bonds, without full commitment from the Member States and clear communication of *all* the implementation details, might seriously hamper the European economy. A very extensive study is therefore required. As a possibly significant investor in stability bonds, APG is willing to cooperate with the European Commission and to share its expertise.

IDENTIFICATION OF RESPONSE

APG provides pension management, pension communication, asset management, management support for pension funds. APG helps pension funds manage their participants' pensions in the best way possible with these services. APG manage pension assets in excess of EUR 275 billion Euro and provides for the retirement income of around 4.5 million participants.

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