EUROPEAN CENTRAL BANK
EUROSYSTEM

13 July 2016

INSTITUTIONAL INVESTOR DIALOGUE

Frankfurt am Main, 22 June 2016
10 a.m. to 12.30 p.m. CET, Sonnemannstrasse 20

SUMMARY

Participants

- Members of the Governing Council of the ECB (or their alternates)
- Representatives of Aegon Asset Management, Amundi, Assicurazioni Generali, AXA, BlackRock, MAPFRE, Nomura Asset Management UK, Pioneer Investments, State Street Global Advisors, PGGM, Union Investment and Zurich Insurance Group
- ECB officials from the Directorates General Market Operations, Communications and Secretariat

Global Investment Trends

Participants held the view that current circumstances are challenging for savers and investors. It was argued that pension funds and insurance companies could not benefit from declining bond yields because, despite the significant capital gains on the asset side, decreasing discount rates have often led to an even faster increase in their liabilities. For insurance companies, it would be challenging to meet their clients' demand for sufficiently high returns and guarantee and maintain the liquidity required by regulators without opening the duration gap between assets and liabilities.

One investor observed that the globally discernible rise of political uncertainty was the result of increasing underemployment and lower wages in developed economies which stemmed from the technological changes that created a historically wide skill-gap between labour supply and labour demand. He added that fiscal policies need to have long term views and help creating jobs via much needed infrastructure development.

One investor doubted that meaningful fiscal stimulus would be implemented in the euro area in the foreseeable future. One Governing Council member noted that if expansionary fiscal policies were applied in fragile economies, markets tend to punish that with higher expected risk premium. One investor's view was that Public Private Partnership would help resolve this controversy as they would reduce the actual fiscal burden of expansionary policies.

Corporate short-termism was mentioned as one of the main obstacles for investment activity. Companies cut back their productive long-term investments and instead aim at enhancing their equity price valuations by improving profitability ratios with short term measures. One investor suggested that bank stress tests should not only focus on quantitative risks but also qualitative risks, like the quality of boards. One investor emphasised that Solvency-II regulation and IFRS requirements force insurance companies to take short term views in their investment decisions and to hold a significant amount of low-yield assets.

Outcome of the survey of participating investors

Most participating investors were of the view that of the ECB's asset purchase programmes, the Public Sector Purchase Programme was the most effective as it helped anchoring yields and volatility at low levels. Regarding the CBPP3, while most of the investors acknowledged the spread tightening and the increased issuance activity, their common concern was deteriorating market liquidity. As far as the ABSPP was concerned, investors took the view that the relatively small size of the market limited the programme's effectiveness.

Investors agreed that it was too early to draw consequences from the ECB's Corporate Sector Purchase Programme. Nevertheless, they expected increasing issuance and spread tightening going forward. Some investors warned that as a result of the CSPP, it became more difficult for institutional investors to receive allocations of decent size from new issuances and secondary market liquidity may also deteriorate. One investor recalled that in the European corporate sector, bank financing was still dominant relative to capital market financing, making the transmission channel of the CSPP potentially weaker.

Regarding the perceived diminishing returns of monetary policy measures, one Governing Council member explained that the lack of stimulus in other policy areas created headwind which, in turn, created the illusion of diminishing returns.

Direct lending – recent trends and outlook

Investors considered direct lending to be an attractive investment opportunity from the perspective of diversification of their assets. In particular mid-sized corporates may find direct lending useful in their process of diversifying their funding structure.

According to their figures, direct lending currently represented about 2-4% of pension funds and insurance companies' assets under management, and growth in recent years has been slower than previously anticipated.

Another investor held the view that direct lending was bound to remain a small asset class because (i) institutional investors possessed less expertise in lending relative to banks, (ii) returns related to direct lending may be highly correlated with other asset classes' returns and (iii) related solvency charges were high.

Investors agreed that direct lending was expected to remain complementary to bank lending. They were of the view that partnership with banks will remain a key feature of this asset class given that banks have the indispensable capabilities to ensure the adequate credit monitoring and servicing throughout the entire lifetime of the loans.

One investor reported on the pension funds’ experience where direct mortgages have been launched targeting pension fund members. Another investor warned that although the illiquid nature of this asset class might not be an issue for long-term investors, potentially restrictive regulatory frameworks would create a hurdle for further development in direct lending.

Separately, participants briefly discussed the market for non-performing loans (NPL). One investor saw potential in buying NPLs from banks, while others noted information asymmetry and illiquidity issues, as well as the difficulty to match NPLs with institutional investors’ liability structure.