aba – Arbeitsgemeinschaft für
betriebliche Altersversorgung e.V.

aba position paper
on the European Commission's Proposal
for a Regulation on a pan-European Personal Pension Product (PEPP)
and the Recommendation on the tax treatment of personal pension products

The **aba - Arbeitsgemeinschaft für betriebliche Altersversorgung e.V**. - is the German association representing all matters concerning occupational pensions in the private and public sector. The aba has 1,100 members including corporate sponsors of pension schemes, IORPs, actuaries and consulting firms, employer associations and unions, as well as insurance companies, banks and investment managers. According to our statutes, our mission is to represent existing schemes as well as to expand coverage of occupational pensions independent of vehicle. We are a member of PensionsEurope, where we are active both on the board and in a variety of working groups.

Main points

- The proposal for a Regulation on a pan-European Personal Pension Product and the Recommendation on the tax treatment of personal pension products, including the PEPP are not sufficiently thought through. Indeed, many questions remain unanswered.

- We doubt that the proposed PEPP Regulation is fit for purpose, i.e. that it can address the goals set by the Commission itself.

- We doubt whether the level of pick-up by European citizens will be anywhere close to that anticipated by the EY study if the PEPP is not granted the unjustifiably attractive tax framework "recommended" by the Commission– because of both supply and demand side issues.

- If the PEPP is accompanied by a generous tax framework which partly addresses the demand side issues, we anticipate serious implications for existing second and third pillar provision.

- Authorisation and supervision of the PEPP: An example of an issue, that should be discussed openly and not simply glossed over is whether the cost for the additional tasks EIOPA will take on with the introduction of the PEPP should not more logically be covered by those providing the PEPP, rather than by all institutions EIOPA supervises.

- The PEPP Regulation and accompanying Tax Recommendation therefore not only address regulatory questions, but also imply fundamental tax and pension policy questions which remain the key responsibility of the Member States. As a minimum requirement of good governance, we consider it essential that the EP Committee EMPL and the Social Affairs Ministers have their say and decide on the Regulation in addition to ECON and the Finance Ministers.

- Overall, we would like to stress again that social policy is and should remain a key task of the Member States and not be set by the Commission without or with only token involvement of the Member States.

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Introduction

The European Commission published its Proposal for a Regulation on a pan-European Personal Pension Product (PEPP) on 29 July 2017 (press release, related documents). The aim of the proposal is to set the framework for a personal pension product with certain fixed features (e.g. information requirements, investment choice), while only a few other features can be decided at Member State level (e.g. pension age, minimum length of contributions). The intention is to make the product portable by requiring providers (after an initial three year period) to offer the PEPP across all EU Member States, taking into account the features set at national level, and, more importantly, national tax law. Alongside the Proposal, the Commission has published a Recommendation calling on the Member States to grant the PEPP a tax framework equivalent to that of national personal pension products, even if the PEPP does not fulfil all requirements the national products have to fulfil in order to benefit from a certain tax framework.

In this paper, we raise the general point that the Proposal and the Recommendation on tax are half-baked. After that we go into more detail, looking at the problems the Commission seeks to solve with the Regulation and comment on the potential take-up of the PEPP. As we have pointed out in previous position papers, the tax framework set for the PEPP by the Member States will be crucial in making or breaking the PEPP. We would like to point out that depending on the tax framework, the PEPP might have an impact on existing second and third pillar pension provision. Taking this impact into account, the introduction of the PEPP and the choice of the adequate tax framework would be social policy making – a competence which firmly sits with the Member States and should remain there.

Supporting this paper, we have put together an Annex which provides an overview of the relevant points raised in the Impact Assessment, the Opinions provided by the Regulatory Scrutiny Board on the Impact Assessment, and on the feasibility study.

1. **The proposal for a Regulation on a pan-European Personal Pension Product and the Recommendation on the tax treatment of personal pension products, including the PEPP are not sufficiently thought through. Indeed, many questions remain unanswered.**

We have followed the process leading up the Proposal closely and have studied the Proposal itself and the accompanying documents carefully, but from our perspective a lot of questions remain unanswered. The questions set out below show that more analysis and thinking is required to turn the Commission's proposal into a thought through piece of legislation. Ideally, the Commission would withdraw the Proposal and issue a new one. However, since the legislative procedure is already under way and this seems unrealistic, we call on the European Parliament and the Council to improve the Commission's proposal in this regard. The PEPP Regulation should be limited to product regulation, other issues (e.g. provision of information) should be moved to a PEPP Directive. The Directive would give Member States the leeway they need to tailor the PEPP to their national systems, while the Regulation can still ensure that the PEPP maintains a European character.

Turning to the questions the proposal does not address, the most important questions remain unanswered around the issue of taxation. This is of course unsurprising, because the Commission has no mandate in taxation issues. However, if the PEPP Regulation is supposed to be launched, certain issues have to be addressed at the European level (while of course the most important decision will have to be made at Member State level):

Will a transfer of assets to a different compartment trigger taxation in the Member State where the first compartment was built up (this problem is raised in the Impact Assessment, p. 48)? What happens if someone saves for a PEPP under an EET framework, then moves to a Member State with a TEE framework and transfers the assets? In other words, will it be possible to use the PEPP as a tax avoidance vehicle? Will there be the need for Double Taxation Agreements?

Regarding the provision of annuities, a key question is whether the consequences of changing the provider during the pay-out phase have been thought through: if customers can leave at any point during the decumulation phase, it becomes very difficult to provide attractive annuities. Those who expect to die soon are likely leave the provider (e.g. because they were diagnosed with a grave illness) in order to get a lump sum. Adverse selection problems would increase and make it close to impossible and in any case very expensive to offer lifelong pensions.

Other important questions refer to the capital protection set out in Article37 (Default investment option):

What is meant by "capital protection" – is it merely a call to use risk-mitigation strategies (as suggested by Art. 37.1) or is it a hard guarantee of the nominal amount paid into the PEPP (as suggested by Art. 37.2)? If it is the latter, is the guarantee applied to the amount of money paid into the PEPP before or after charges?

We are still working on an Annex listing other minor and major open questions. The issues raised above and the list in the Annex show that the Commission Proposal needs more work and should not be rushed through the legislative process. As stated above, any questions also remain open regarding the tax treatment of the PEPP, however, this is an area where the Commission has not competence to answer any questions.

2. **We doubt that the proposed PEPP Regulation is fit for purpose, i.e. that it can address the goals set by the Commission itself.**

The Commission states three broad areas in its problem definition.[1] We will address these in turn.

The first problem raised by the Commission is that **capital markets are underdeveloped in the capital markets union context.** In the context of the proposal, the Commission criticises market fragmentation and describes how pension funds play a bigger role as institutional investors in the US (p. 2). However, if this is desirable, the PEPP seems an odd approach to achieve this: Introducing a new product is likely to lead to more fragmentation rather than less, and if the aim is to strengthen pension funds, this should be done directly by strengthening occupational pensions rather than strengthening pension funds by allowing them to offer a highly complex third pillar product.

On a more general note, we would like to emphasise that social policy in itself is immensely important – people's livelihoods depend on it. We are therefore against any initiative to strengthen the capital markets union

[1] Proposal for a Regulation on a pan-European Personal Pension Product, p. 2; see also Impact Asessment, Problem definition, p. 9.

which takes away the prerogative of the Member States to steer their social policy. Social policy should not be subordinate to capital markets union policy – to the contrary, the capital markets union should be set up in a way to support pension policy as well as broader social policy objectives.

The Commission secondly raises the issue of **insufficient features in the area of personal pension products**. The Impact Assessment lists a number of product features (e.g. disclosure of information, distribution, diverse levels of net performance after costs and charges and others) which are deemed inadequate in some personal pension products. According to the Impact Assessment, these concerns might limit the attractiveness of national personal pension products.

We would like to point out that some of the issues raised are inherent to personal pension products: while for example the disclosure of information is important, there will always be an information asymmetry between the provider and the consumer. Pensions being a complex topic, consumers are less well informed than providers, making comparisons between different products difficult or even impossible.

Another issue inherent to personal pension products is that consumers will always have behavioural biases such as instant gratification (preferring to spend the money straight away rather than saving it for later) and inertia (postponing to sign up for a personal pension). We do not see how a PEPP would address any of these issues which are inherent to personal pensions.

From our perspective, occupational pensions follow a structural approach which addresses these problems. In Germany, the employer gives a pension promise to the employee, often within a framework agreed by the social partners, which means that the employee does not have to / cannot choose a vehicle, investment strategy etc. Often the employee can decide whether to make additional contributions, but this is a much less complex choice than buying a personal pension product. This set-up for pension provision has been developed over decades and works well and efficiently. The recent reform to strengthen occupational pensions (Betriebsrentenstärkungsgesetz) has shown that this is acknowledged in Germany after 15 years of experience with personal pensions (Riester pension reform in 2001).

Other features which are deemed insufficient in existing national personal pension products might be rooted in different approaches to social policy and understanding of pension provision, for example the protection of the savings invested in the personal pensions or restrictions in the pay-out phase. Depending on the set-up of the other pillars and of social assistance, it might be reasonable to have personal pensions only with capital protection and/or to impose limits on decumulation options (e.g. encouragement or enforcement of life-long pension payments to avoid individuals outliving their savings and falling into poverty and therefore tax-financed social assistance. For these questions, an exchange of good practices at the European level could make sense – Member States could learn how things work elsewhere and – if they wish to do so – change their existing pension systems. Introducing a PEPP is not necessary in this regard and might even be harmful by introducing a product not tailored to the national set-up.

As a third problem, the Commission deems the **internal market for personal pension incomplete**. The Commission finds “hardly any cross-border activity by suppliers or savers”.[2] Recital 3 of the Proposal states “Cur-

[2] Proposal for a Regulation on a pan-European Personal Pension Product, p. 2.

rently, the functioning of the internal market for personal pensions is impeded by the high degree of fragmentation between national markets and the limited degree of portability of personal pension products." We ask the EU Commission to provide evidence for the statements made in this recital.

From the perspective of the individual, third pillar personal pension products (PPPs) do not constitute a real barrier to movement: if someone decides to move to another EU country, they will do so regardless of their PPP. Other barriers (language, finding work, leaving behind country, culture, friends etc.) are much more significant than personal pensions.

Turning to the free movement of services, it is already possible for EU providers to offer personal pensions in many Member States (MS), while of course following national requirements (such as e.g. the requirements to attract the Riester tax framework) and based on EU prudential regulation like the IORP Directive, Solvency II or the UCIT Directive.[3] So it is already possible today for large providers to benefit from economies of scale by offering products or organizing occupational pensions across the EU. We would like to emphasise that many multinational corporations are already making use of these possibilities by pooling occupational pension assets and using joint administration across different jurisdictions.

3. **We doubt whether the level of pick-up by European citizens will be anywhere close to that anticipated by the EY study if the PEPP is not granted the unjustifiably attractive tax framework "recommended" by the Commission – because of both supply and demand side issues.**

We also doubt that the PEPP will be a success, because of both supply and demand side issues if there is no generous tax framework attached.

On the supply side: as far as we can see, only very large providers – which are potentially already active across the EU – will be able to offer the PEPP with its 27 compartments (after the initial three year period). For medium or even small IORPs / providers which currently offer an occupational or personal pension in one jurisdiction only, it will be close to impossible to build up or buy in the expertise to offer the PEPP across the EU. One response to this problem might be to relax the requirement to offer the product in all 27 Member States - however, this would mean that the PEPP would lose its EU-wide approach and with that one of its distinguishing characteristics.

[3] The Impact Assessment acknowledges this and stresses the added value the PEPP can offer as follows: "The possibility to create sections already exists today. The added value of the PEPP initiative would consist in putting on the market a PEPP with certain degree of standardisation, which could contribute to making PEPPs less expensive than the already existing personal pension products. In addition, the PEPP framework would streamline the exchange of information between supervisors to allow for the creation of new sections, and the information provided to PEPP savers. Thus, the supply of this partially standardised PEPP would be easier and bring about economies of scale; its take-up would potentially be higher, prompted by better recognition and confidence on the part of customers. It is the partial standardisation of key PEPP features that is expected to facilitate cross-border asset pooling and make it cheaper, compared with the present situation. The national compartments of such a PEPP, marketed through a section approach, can be designed so as to qualify for national tax advantages." (IA, p. 47)

The Commission calls for greater choice when it comes to personal pensions.[4] We call on the Commission to back up this statement with evidence, showing that the lack of supply is limiting demand, rather than the issues set out below.

On the demand side: First of all demand for third pillar products depends on the set-up of the overall system of retirement provision. If first and second pillar already provide sufficient income in retirement, demand for a third pillar product is likely to be low. Another key reason for low take-up of pension savings products is that individuals do not have the means to set money aside for their retirement. If this is the case, no new product, increased supply, information provision etc. will increase demand and take-up. We regret that the lack of purchasing power was not included in the Impact Assessment of the PEPP.[5] This means that both the need for the PEPP and its potential impact could have been overestimated. We understand that an Impact Assessment cannot cover all possible points. However, for questions around the take-up of personal pension products, a key question is whether potential clients actually have extra money they can set aside for their retirement. If this is not the case, the best product with the best regulation in terms of transparency and portability will not broaden personal pension coverage. Lack of purchasing power is therefore a key aspect when discussing personal pensions and should be included in the Impact Assessment.

We would also like to stress that people are not always rational – even though they have the resources, they might postpone joining a personal pension or they might just prefer to spend the money straight away rather than setting it aside for later (see the points raised above). They might also be overwhelmed by too much choice (choice overload). So even if they have the resources available and good products are on offer, take-up might be relatively low. Occupational pensions have found solutions to these problems by e.g. auto-enrolling employees in an occupational pension scheme.

4. **If the PEPP is accompanied by a generous tax framework which partly addresses the demand side issues, we anticipate serious implications for existing second and third pillar provision.**

One way to stimulate demand would be for the Member States to offer generous tax frameworks for the PEPP. However, if this was the case, people might move contributions they had previously made to existing second and third pillar schemes offering in contrast to PEPP more than long-term saving. It is likely that this would have a significant (negative) impact on existing schemes. It is not enough for the Commission to state that they do not intent for this to happen (After giving a generally positive outlook for the PEPP – which is not backed by evidence - , Recital 11 closes with the statement "This framework will not replace or harmonise existing national personal pension schemes."[6]). Even if the Regulation makes this statement, contributions could be moved from existing second and third pillar pension schemes into the PEPP, in particular if the tax framework

[4] E.g. „People who wish to save more for retirement need a greater choice of suitable personal pension products that rely on capital markets-based investments." (Proposal for a Regulation, p. 2).
[5] Impact Assessment, p. 26.
[6] Recital 11 states "A legislative framework for a PEPP will lay the foundations for a successful market in affordable and voluntary retirement-related investments that can be managed on a pan-European scale. By complementing the existing pension products and schemes, it will contribute to meeting the needs of people wishing to enhance the adequacy of their retirement savings, addressing the demographical challenge and providing a powerful new source of private capital for long-term investment. This framework will not replace or harmonise existing national personal pension schemes."

for the PEPP is generous and the Commission is pushing the Member States to give the PEPP preferential treatment over their national products (by offering the same tax framework as they offer to national personal pension products, but potentially with fewer strings attached). To understand this effect and its potential scale, it is crucial that the European Parliament and the Council have this issue carefully analysed and take the results into account.

The Impact Assessment currently acknowledges that substitution might occur[7], but does not provide any deeper analysis. In addition, occupational pensions should be included in the list of areas which might be affected (see text in footnote 7), otherwise the Commission might fall victim to tunnel vision and might miss important developments.

A number of Member States have well established occupational pension systems. The PEPP is therefore not being established in an empty space. If the PEPP was introduced with a generous tax framework, consumers (and potentially employers) might move contributions they had previously made to existing second and third pillar schemes offering in contrast to PEPP more than long-term saving. It is likely that this would have a significant (negative) impact on existing schemes. It is extremely important not to harm existing systems, as this would erode trust in supplementary pensions. We therefore urge the EU not to exert any pressure to create the announced successful PEPP market at the expense of occupational pensions.

5. **Authorisation and supervision of the PEPP: An example of an issue, that should be discussed openly and not simply glossed over is whether the cost for the additional tasks EIOPA will take on with the introduction of the PEPP should not more logically be covered by those providing the PEPP, rather than by all institutions EIOPA supervises.**

Without doubt, if EIOPA authorised and supervised the PEPP, it would need additional resources to be able to do so. This new cost should be borne by those who offer the PEPP, rather than by all insurance undertakings and IORPs EIOPA supervises. As stated above, we assume that only large insurance companies und asset managers will be in a position to offer the PEPP as currently described in the proposed Regulation. We therefore do not think that it would be adequate if all insurance companies and IORPs had to pay for the additional costs of supervising PEPP providers.

6. **The PEPP Regulation and accompanying Tax Recommendation therefore not only address regulatory questions, but also imply fundamental tax and pension policy questions which remain the key responsibility of the Member States. As a minimum requirement of good governance, we consider it essential that the EP Committee EMPL and the Social Affairs Ministers have their say and decide on the Regulation in addition to ECON and the Finance Ministers.**

[7] „As a voluntary regime, a PEPP framework would not entail any direct consequences for national models or personal pension products which will continue to exist. Nevertheless, a substitution between distinct financial products held by households, from deposits, investment products and PPPs towards the PEPP could occur.“ (IA, p. 35)

Finally, we would like to stress that even though the foremost goal of the PEPP is to improve the workings of the capital markets union, it in fact is a social policy initiative. The PEPP Regulation together with the tax recommendation therefore not only addresses regulatory questions, but also implies fundamental tax and pension policy questions which are a key task of the Member States. Pension systems differ hugely across the EU[8], there are differences between first and second pillar pension provision and not least between the individual's need and ability to save. In addition, the understanding of what constitutes good retirement provision as well as the financial situations of the Member States and the possibilities of granting a tax framework for pension saving are very different. All this means that Member States are in the best position to make decisions about their pensions systems – this should be respected rather than being undermined by a regulation focusing on the capital markets union.

The least is that EP Committee EMPL and the Social Affairs Ministers have their say and decide on the Regulation in addition to ECON and the Finance Ministers. Overall, we would like to stress again that social policy is and should remain a key task of the Member States.

Berlin, 17 October 2017 VM/SD

[8] Generally, we note that (particularly the Impact Assessment) regards differences in rules at the national level as problematic („remedy the current patchwork of national regulations". p. 2 of the Executive Summary of the Impact Assessment). We would like to stress that differences in national regulation are not necessarily negative. Personal pensions play a different role in different national pension systems, depending on how the first and second pillars are designed. These differences are reflected in national regulation, e.g. the level of tax limits, regulation around investment options and decumulation. Differences in national regulation have a purpose, it is not something which needs to be "remedied".