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Towards a Harmonized European Legislative Framework for

PAN EUROPEAN PERSONAL PENSION (PEPP)

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KEY FINDINGS:

- The PEPP will play a major role in overcoming the 'pension's gap' and providing choices to consumers.
- The PEPP initiative should be established as a regulation.
- The PEPP could be defined and regulated as a wrapper of existing European Economic Area (EEA) eligible third-pillar pension products (AIFs, UCITS, IORPs resembling investment funds and unit-linked insurances).
- Product providers and distributors could be regulated under existing sector regulations and according to the type of PEPP – insurance or investment (fund) based PEPPs.
- On the tax front, extending the EET system by individual Member States to the PEPP would provide the right tax incentives. Member States should consider to renegotiate relevant tax treaties for mobile workers and pensioners.
- The PEPP could be extended to the first and second-pillar domain by individual Member States.

THE PEPP: A PENSION SOLUTION FOR THE FUTURE

In the last couple of years, questions arose on how the Pan European Personal Pension product (PEPP) should ideally be regulated. As the European Commission prepares to release a legislative proposal on a framework for the PEPP in June 2017, Prof. Dr. H. Van Meerten[1] and S. N. Hooghiemstra LL.M.[2] investigate the legal framework for the PEPP, which can lead to a single pension market, facilitate the cross-border supply of pensions and enhance consumer choice.[3]

The PEPP initiative is intended to play a greater role in securing pensions, reducing the burden on public pension schemes and increasing pension income.[4] It may serve as an answer to overcome the pressure being applied by the low interest rates on funded schemes. **The PEPP European initiative, thus, can play a major role in overcoming the 'pension's gap'.[5]**

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THE PEPP AS A REGULATION

EIOPA[9] indicated that the internal market for PEPPs would be substantially enhanced if a PEPP product passport would be introduced.[10] The European passport is proposed by the authors of this research too as it will facilitate 'mutual recognition' across the EU and overcome 'risk asymmetry'.

It would also be logical that the **PEPP initiative should be established as a regulation**, similarly to recent legal initiatives such as ELTIFR.[11] Together with the European System of Financial Supervision introduced in 2011, this would ensure that the PEPP initiative would also be adequately enforced by home/host Member States.

DEFINING THE PEPP: THE PEPP AS A WRAPPER

A viable way to establish a harmonized PEPP regime is by **defining and regulating PEPPs as wrappers of existing European Economic Area (EEA) third-pillar pension products**. The wrapper is composed by the "common features" that PEPP products would be required to comply with, the PEPP regulation and the eligible third-pillar underlying retirement products. (See Exhibit 1.—the PEPP as a wrapper)

In addition to the 'common features', the PEPP regulation would set out additional mandatory elements (i.e., default investment option) and flexible elements (i.e., guarantees). (See Exhibit 2.—PEPP features)

ELIGIBLE THIRD-PILLAR RETIREMENT PRODUCTS

Only EEA regulated third-pillar pension products would be suitable as the underlying products in a PEPP to ensure that PEPP providers do not enter into regulatory arbitrage by choosing a less well-regulated national product as part of a PEPP.

Given the standardized mandatory features of PEPPs, **AIFs, UCITS, IORPs resembling investment funds and unit-linked insurances are the most suitable type of third-pillar retirement products that would be eligible for PEPPS**. These eligible third-pillar retirement products could contain 'insurance' and 'non-insurance products'.

Insurance products could be defined as products (and providers) that are within the scope of Solvency II and may be distributed on the basis of the IDD.

Non-insurance PEPPs could be limited to UCITS, retail AIFs,[13] IORPs[14] and saving products under CRD IV. Regarding IORP, only pure DC IORPs, such as Dutch PPI, will be suitable for the PEPP.

REGULATING PEPP: LEANING ON EXISTING SECTOR REGULATIONS

The PEPP initiative is intended to regulate not only the product, but also PEPP providers, distributors and custodians. This report highlights that leaning on existing sector regulation for both, product manufacturers that manufacture and distribute PEPPs and distributors that merely distribute PEPPs manufactured by others would be targeted according to their roles.

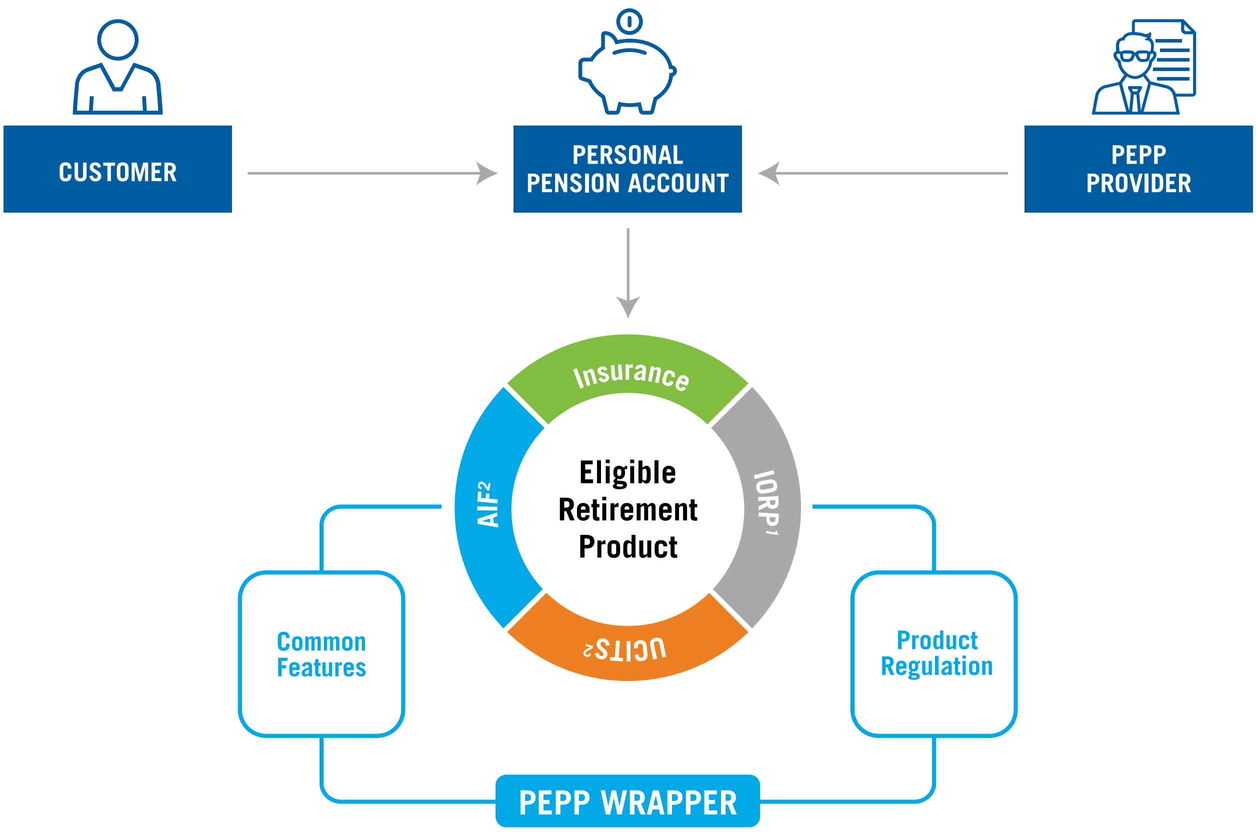
PEPP PROVIDER:

A PEPP provider, defined as an EEA financial intermediary that manufacturers or changes a PEPP, would be limited to:

– Credit institutions authorized under CRD IV;
– AIFMs authorized under the AIFMD;
– UCITS ManCos authorized under UCITSD V;
– Insurance undertakings authorized under Solvency II.

This sectoral approach implies that the above providers may only offer PEPPs that include third-pillar products for which they are authorized.

Exhibit 1. The PEPP as a wrapper product.



1. Depositary/Custodian will be required for IORP.
2. Depositary will be required for UCITS and AIF.

Exhibit 2. PEPP features.

COMMON FEATURES:

- **Individual Membership:** PEPP must be based upon a contract between an individual and a financial institution.
- **Individual Account:** PEPPs are financed by contributions paid to an individual account.
- **Explicit Retirement Objective:** consumers are obliged to invest with an explicit retirement objective and only transfer their account balance from one PEPP provider to another but not outside the "PEPP system".
- **Funded:** financed by contributions paid by individual or third party on behalf of the individual.
- **Limitations of Withdrawals:** early withdrawal of accumulated capital under PEPP is limited, ensuring that accumulated capital is only paid out upon retirement or on the occurrence of a biometric risk.
- **Authorized PEPP providers:** regulated by an existing EEA body of prudential law and meeting EEA PEPP product requirements.
- **Tax:** third-pillar retirement products that qualify as a PEPP may satisfy requisites for special tax treatments in Member States, similarly to other existing products designed to provide income after retirement.

MANDATORY FEATURES:

- **Default Option:** the core default option should contain a de-risking strategy for PEPPs that do not contain a guarantee.
- **Limited Investment Choices:** PEPP provider should provide the customer with a limited number of investment options to help consumer in their choice. All investment choices involve product types in which PEPP holders are not allowed to make individual selections of assets.[12]

FLEXIBLE OR OPTIONAL FEATURES:

- **Guarantees:** PEPPs may choose to provide a guarantee. The provision of a guarantee should be limited to providers subject to Solvency II.
- **Cap of costs and charges:** a cap on charges is not proposed. The cap must be considered as a 'flexible option' for the default option open for the individual Member States to decide. In any case, the costs for the default product should be lower than the alternative options.
- **Switching between providers:** PEPPs are long-term products. Switching providers and transferring funds should allow consumer flexibility. Some limitations on switching, including a minimum holding period should be allowed to overcome liquidity management issues.

PEPP DISTRIBUTOR:

Extending the IDD and the MIFID II to PEPPs will lead to consistency between distribution of PEPPs that are insurance and non-insurance based.
The sectoral approach allows AIFMs and UCITS ManCos as PEPP providers that are under the AIFMD and UCITS V authorized to market AIF/UCITS units to consumers.
In addition, investment firms/credit institutions under MiFID II and insurance companies/undertakings under the IDD would be allowed to distribute PEPPs. Regarding suitable IORPs for the PEPP (pure DC IORPs), the case can be made to allow for their distribution under the MIFID II regime, considering their similarity to investment funds.

> **"The PEPP will lead to a single pension market, facilitate the cross-border supply and enhance consumer choice.**

TAXATION OF THE PEPP

Differences between Member States related to the deductibility of contributions and the taxation of benefits could possibly pose a problem for PEPP holders.[15]
Tax deferral has proven to be an effective incentive for taxpayers to save for retirement. Politically, it is hardly feasible to harmonize the direct taxation field. **Extending the EET system[16] to all Member States would eradicate most, but not all, problems.**

The idea of a 'compensating layer', or substitute tax relief, by a matching contributions system has been also explored in the scope of this research.

The EET system could be complemented by the renegotiation of tax treaties between relevant Member States to resolve issues related to, for example, migrant workers and pensioners. Even if tax obstacles are not remedied on the European level, the introduction of the PEPP would still lead to a single market for PEPPs, as it facilitates the cross-border supply of PEPPs and enhances consumer choice and reduces costs.[17]

THE FUTURE OF THE PEPP

An overview of the regulatory framework of Personal Pension Plans in Sweden, the UK and the US, indicates that **the PEPP might inspire the European regulator and individual Member States to extend the PEPP to the second-pillar domain.** Furthermore, the PEPP initiative could easily allow Member States to optionally extend the initiative to their national first pillar and second pillar legal regimes.[18] This would gradually lead to a standardization of pension products throughout the pension pillars in Europe in a so-called 'pensions union'.

The PEPP initiative is a third-pillar personal pension product that does not restrict PEPPs to be marketed to EEA consumers exclusively. Although the EEA does not have the competence to unilaterally decide to extend the PEPP product passport to third countries, it leaves it up to third countries to allow PEPPs to be marketed to their consumers on a 'private placement' basis.

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1. Professor International Pension Law, Utrecht University.
2. Doctoral candidate, Utrecht University.
3. European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 38.
4. Cf. European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 7–9.
5. See the responses of APG, Better Finance response to Consultation Paper 16-001: European Insurance and Occupational Pensions Authority, *Summary of Comments on Consultation Paper 16-001*, 14 July 2016, EIOPA-BoS-16/467, 20, 44; European Commission, White Paper—An Agenda for Adequate, Safe and Sustainable Pensions, 16 February 2012, COM(2012) 55 final{SWD(2012) 7 final}{SWD(2012) 8 final}.
6. The views expressed in these materials are those of the authors and not necessarily those of Franklin Templeton Investments and First Pensions.
7. First Pensions Financial Analyses & Support B.V. ("First Pensions") is a specialist Dutch pension fund consultant and financial Risk Manager, based in the beautiful city of Utrecht in The Netherlands, Europe. It is known for its innovative solutions and risk management reporting for the financial sector. Together with its pension fund clients, First Pensions helps to both protect and boost the approx. €35 billion in pension assets of the funds' more than 700,000+ pension scheme members.
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9. EIOPA, European Insurance and Occupational Pensions Authority.
10. European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006.
11. ELTIFR, European Regulation on Long-Term Investment Funds.
12. European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 18.
13. Art. 43 AIFMD.
14. Apart from the EEA provisions related to the 'occupational nature', IORPs may be construed in a similar way as national voluntary pension funds. Nevertheless, IORPs are a fully harmonized European product that has embedded under IORPD II the latest EEA regulatory developments.
15. Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 18.
16. *Exempt contributions, Exempt investment income and capital gains of the pension institution, Taxed benefits.*
17. European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 38.
18. See European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions—An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, Annex 1-4.