EU Regulation and Recommendation

PAN-EUROPEAN PERSONAL PENSION PRODUCT (PEPP)

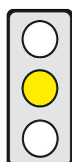
cep**PolicyBrief** No. 28/2017

Centrum für Europäische Politik

KEY ISSUES

Objective of the Regulation: The Commission wants to create a single market for personal pension products.

Affected parties: Banks, insurance companies, institutions for occupational retirement provision, investment fund companies, insurance distributors, savers



Pro: The markets for personal pension products are highly fragmented along national lines. The Commission's quest to bring down barriers is therefore worthy of recognition.

Contra: (1) Whether the Regulation will actually facilitate an internal market for personal pension products is doubtful. The main obstacle – the diverse socio-political and tax rules – continues to exist.

(2) The obligation to provide advice distorts the market process in favour of the – lowest yield – default investment product.

The important passages in the text are indicated by a line at the side.

CONTENT

Title

Proposal COM(2017) 343 of 29 June 2017 for a **Regulation** of the European Parliament and of the Council **on a pan-European Personal Pension Product (PEPP)**
Recommendation (2017) 4393 of the Commission of 29 June 2017 **on the tax treatment of** personal pension products including **the pan-European Personal Pension Product**

Brief Summary

► **Context, definitions and objectives**

– The Commission wants to create a framework for a pan-European Personal Pension Product (PEPP). The PEPP will supplement existing national pension products rather than replacing or harmonising them (known as 2nd Regime). (Explanatory Memorandum p. 2 and 3)
– PEPPs are long-term savings products for retail investors and acquisition is voluntary. They provide an income during retirement and have no or strictly limited redeemability. (Art. 2 Nos. 1–3) They can also cover biometric risks, i.e. longevity, disability and death (Art. 42).
– The Regulation distinguishes between PEPP providers and PEPP distributors:
  - PEPP providers are state authorised financial undertakings – banks, insurance companies, institutions for occupational retirement provision, investment fund companies – that manufacture and distribute PEPPs (Art. 2 No. 14 in conjunction with Art. 5 (1)).
  - PEPP distributors are financial undertakings and full-time or part-time insurance intermediaries who only distribute PEPPs, i.e. do not manufacture them themselves (Art. 2 No. 15).
– The Regulation will (Explanatory Memorandum p. 2–5)
  - create a single market for personal pensions and promote competition,
  - channel savings towards the capital markets and away from traditional savings deposits in banks and
  - increase the distribution of personal pension products in the EU.
– The Regulation is accompanied by a Recommendation which puts forward non-binding requirements for the tax handling of PEPPs in the Member States.

► **Manufacture, authorisation and distribution of PEPPs**

– PEPPs must be authorised by the European Insurance and Occupational Pensions Authority (EIOPA) (Art. 4 (1)). Authorisation is valid EU-wide (Art. 4 (2)).
– Existing national pension products can also be distributed as PEPPs following authorisation by EIOPA (Art. 7 (2)).
– PEPP providers must be authorised by the competent authority (Art. 5 (1)). PEPP distributors do not require authorisation.
– PEPP providers can distribute their – own– PEPPs. In order to distribute PEPPs – which are not their own –, PEPP distributors require (Art. 8)
  - authorisation from their national regulatory authorities if they are financial undertakings,
  - no authorisation if they are insurance intermediaries.
– PEPP providers and PEPP distributors can also manufacture and distribute PEPPs in other EU countries under the freedom of establishment and freedom to provide services (Art. 11).

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- **Portability of PEPPs when changing domicile to another EU country**
  - Savers have the right to continue contributing to their PEPPs when they change their domicile to another EU country. In this case, they are still entitled to retain all advantages and incentives agreed with the PEPP provider ("portability service"). (Art. 12)
  - On opening a PEPP, a national compartment will first be created in the PEPP corresponding to the saver's domicile (Recital 20).
  - On each change of domicile to another EU country, the PEPP provider must open a new compartment for the new country of domicile. For this opening, the existing contract must be amended or a new contract signed. (Art. 13–15)
  - The law in the respective country of domicile applies to each compartment. In particular, each compartment must comply with the respective legal requirements and conditions for using incentives fixed at national level, such as e.g. tax regulations. (Art. 13–15)
  - When proposing a PEPP, PEPP providers must inform potential savers about which national compartments of a PEPP are immediately available (Art. 13 (2)).
  - No later than three years after entry into force of the Regulation, every PEPP must offer national compartments for all Member States (Art. 13 (3)).
  - At the request of the saver, the accumulated assets from various national compartments can be consolidated in the compartment of domicile (Art. 16).

- **Switching PEPP provider**
  - Savers can switch their PEPP provider no more than once every five years. For this, PEPP providers must enable the transfer of any credit balance to another PEPP provider ("switching service") (Art. 45 et seq.).
  - Fees and charges for closing the old PEPP account cannot be more than 1.5% of the saved positive balanced (Art. 45 et seq.).

- **Investment rules for PEPP providers and savers**
  - PEPP providers must invest in accordance with the "prudent person" rule, in the "best long-term interests" of the saver and "predominantly" on regulated markets. Investments must be "properly diversified" and must not expose the provider to excessive leverage and maturity transformation risks. (Art. 33 (1)) Where stricter sectoral rules for a PEPP provider exist in this regard, they will apply (Art. 33 (2)).
  - PEPP providers can offer PEPP savers a maximum of five investment options. One option represents the default investment option which "guarantees" full repayment of the capital invested. PEPP savers can opt for a different investment option once every five years free of charge. (Art. 34–39)

- **Conditions relating to the accumulation phase and paying-out phase**
  - The conditions relating to the accumulation and paying-out phases are essentially determined by the Member States. This concerns for example the minimum duration of the accumulation phase, minimum and maximum in-payments, retirement age and minimum period of belonging to a PEPP savings scheme. (Art. 40 and 51)
  - On conclusion of the contract, PEPP providers can give PEPP savers a choice of up to four pay-out options: annuities, lump sum, regular out-payments up to a maximum limit ("drawdown payments") and a combination thereof (Art. 52).
  - In the accumulation phase, the saver can change the option every five years (Art. 52, Art. 2 No. 13).

- **Distribution rules and information requirements**
  - For every PEPP, PEPP providers must issue a basic information sheet with the main features of the PEPP pursuant to the PRIIPs Regulation [(EU) No. 1286/2014, see cep**PolicyBrief**]. (Art. 23 (3) and (4))
  - PEPP providers and PEPP distributors must provide information relevant to distribution in electronic form as standard (Art. 21). They must inform potential savers about the financial position of the PEPP provider and the past performance of "investments" in their PEPP scheme (Art. 23 (4) and (5)).
  - PEPP providers must prepare a personalised "Benefit Statement" for every PEPP saver and every PEPP beneficiary - before and after retirement - with benefit projections, pay-out options, accumulated capital and the accrued entitlements (Art. 27–31).
  - PEPP savers can only waive their right to advice when they choose the default investment option (Art. 26(1)).
  - PEPP distributors that are insurance intermediaries or investment firms must comply with the relevant rules under the Directive on the distribution of insurance products which have been transposed into national law [IDD Directive (EU) 2016/97, see cep**PolicyBrief**] or the Markets in Financial Instruments Directive (MiFID II 2014/65/EU, see cep**PolicyBrief**) – e.g. on remuneration, information requirements, investor protection and on conflicts of interest (Art. 18–32).
  - All PEPP providers and those PEPP distributors who are neither insurance intermediaries nor investment firms, have to meet the distribution rules under this Regulation (Art. 20, 24 and 25). These rules are based partly on the Insurance Distribution Directive – e.g. in the case of pre-contractual information requirements – and the Markets in Financial Instruments Directive – e.g. in the case of rules on fees, commissions and other non-monetary benefits as well as on obtaining information about the saver's knowledge of PEPPs.

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- **Supervision**
  - The competent authority in the PEPP provider's home Member State monitors compliance with the Regulation. Where a PEPP provider has a branch office or "permanent presence" in another EU country, the authority there is partly responsible. (Recital 17, Art. 55 (1) and (2))
  - EIOPA can assist the national authorities in the settlement of disputes. Where the authorities do not agree, it can settle the matter with a Decision. Where an authority fails to comply with the Decision, EIOPA can address Decisions to the PEPP provider or distributor concerned. (Art. 56)
- **Tax treatment of PEPPs**
  - Member States are "encouraged" to grant PEPPs the same tax relief as they grant their national personal pension products, even if the product features do not match up (Recommendation No. 2.1, sub-para. 1)).
  - Where there is more than one type of personal pension product in a Member State, PEPPs should be granted "the most favourable tax treatment" which this Member State grants to their national personal pension products (Recommendation No. 2.1, sub-para. 2).

Statement on subsidiarity by the Commission

According to the Commission, the legal fragmentation in pension product regulation is impeding completion of the single market.

Policy Context

The Commission already looked at the creation of a pan-European personal pension product in the Capital Markets Union action plan [COM(2015) 468, see cep**PolicyBrief**], in the Communication on Capital Markets Union [COM(2016) 601] and in the Communication on the Mid-term Review of the Capital Markets Union [COM(2017) 292].

Legislative Procedure

29 June 2017	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Options for Influencing the Political Process

Directorates General:	DG Financial Stability, Financial Services and Capital Markets Union (leading)
Committees of the European Parliament:	Economic and Monetary Affairs (leading), Rapporteur: Sophia in't Veld, ALDE
Federal Ministries:	Federal Finance Ministry (leading)
Committees of the German Bundestag:	EU Affairs (leading);
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

Formalities

Competence:	Art. 114 TFEU (internal market); Art. 292, sentence 4 TFEU (legal basis for Recommendations)
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

The markets for personal pension products are highly fragmented along national lines. The main cause of this is the existence of diverse socio-political and tax rules which the Member States use to motivate their citizens to invest in their retirement pensions. Added to this is the lack of portability, i.e. when moving to another EU country, further contributions into a pension product is often not possible due to socio-political rules in the Member States or is unattractive for tax reasons. These obstacles are barriers to market entry which restrict competition and prevent economies of scale. They drive the costs of pension products. They also restrict the cross-border mobility of EU citizens. **The Commission's quest to bring down barriers is therefore worthy of recognition.**

However, whether the PEPP Regulation will actually facilitate an internal market for personal pension products is doubtful. Not only does the Regulation leave the socio-political differences untouched, the Commission, by using only a non-binding recommendation, also fails to properly tackle the tax differences, such as whether taxation should take place in the paying-in phase or not until the paying-out phase. This may be for political reasons: Direct taxes can only be harmonised in the EU with the unanimous agreement of the Member States. Such unanimity is, however, extremely unlikely because the Member States regard tax policy as a core part of their national sovereignty. In addition, there is unlikely to be a common understanding – due inter alia to

the diverse demographic trends in the Member States – about how to organise appropriate tax treatment of pension products. And even if all the Member States comply with the Commission's recommendation, tax differences – such as whether to tax during the paying-in or the paying-out phase – will continue to exist. **The main obstacle** to the cross-border supply of pension products **– the diverse socio-political and tax rules** applicable to them – therefore **still exists**.

In addition: Since PEPP providers will in any case have to offer national compartments for all EU Member States in three years' time, at the latest, they will have to deal, as they have done up to now, with 28 different tax regimes. This involves significant costs which reduces their willingness to offer PEPPs at all. It is also doubtful, as regards the PEPP savers, whether the cost is worthwhile: Since the support criteria and level of tax incentives will continue to diverge between the Member States in the future, changing to another compartment of the same PEPP following a change of domicile will frequently be unattractive for PEPP savers.

EIOPA's responsibility for the authorisation of PEPP products is appropriate in view of the cross-border nature of the products and the exclusively European product regulation. It should be noted: Where a Member State follows the Commission's recommendation and grants PEPPs the same taxation treatment as national pension products, EIOPA decisions will have an impact on tax policy insofar as the Member State links tax incentives only to the EIOPA authorisation.

The planned fixed five-year time limits for a possible switching of investment or pay-out options by the saver are misguided. PEPP providers should be able to choose their own time limits when designing their products. Where there is transparency in this regard, clients can then decide whether they place value on this flexibility and are willing to bear the accompanying costs because the shorter the time limits, the less planning and investment security there is for providers and the lower the yield will tend to be for savers. Shorter time limits, on the other hand, increase flexibility for savers and may serve consumer protection. Due to the tension between costs and flexibility, neither providers nor savers should be bound by rigid time limits but should be permitted to decide individually on the optimum model for them.

The planned **obligation to provide advice** – from which only the low-risk default investment option is to be exempt – **distorts the market process in favour of the** – generally **lowest yield – default investment option**. This option will therefore have an advantage particularly in online distribution which is to play a central role for PEPPs. The implicit assumption behind this, that the default investment option is the most advisable for the saver, is presumptuous.

Legal Assessment

Legislative Competency

The Regulation is correctly based on the internal market competence (Art. 114 TFEU). PEPP pension products with uniform features facilitate the free movement of labour as well as the freedom of establishment and freedom to provide a service.

Although the Treaties permit harmonisation of direct taxes by unanimous decision of the Council (Art. 115 TFEU), the Commission restricts itself to a recommendation which is correctly based on Art. 292 TFEU, sentence 4.

Subsidiarity.

Unproblematic.

Proportionality with respect to Member States

Unproblematic.

Compatibility with EU Law in other Respects

Unproblematic.

Impact on German Law

The Regulation applies directly in every Member State (Art. 288 TFEU) so that there is no need for a national transposing act. For reasons of legal clarity, however, the national legislation on pension contracts must be adapted. In order to comply with the Commission's recommendation for equal tax handling of PEPPs, the Income Tax Act (Special Expenses, Section 10 et seq.) would have to be amended.

Conclusion

The markets for personal pension products are highly fragmented along national lines. The Commission's quest to bring down barriers is therefore worthy of recognition. However, whether the PEPP Regulation will actually facilitate an internal market for personal pension products is doubtful. The main obstacle - the diverse socio-political and tax rules - continues to exist. The obligation to provide advice distorts the market process in favour of the – lowest yield – default investment product.

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