Summary of the CBBA reflection paper on a pan-European occupational DC pension (PEOP)

Introduction of CBBA-Europe (mission and main activities)

CBBA-Europe (www.cbba-europe.eu) is a Brussels based advocacy organization. It has the legal form of an International Association subject to Belgian law.

The mission of CBBA is to advocate the EU authorities in all those fields related to employee and insurance benefits (pensions, healthcare, well-being in the workplace, etc.).

In particular, the Association collects ideas, good practices and proposals from its members in order to draw reflection papers, joint positions and articles.

With this regard, considering that CBBA is well known by the main European authorities, it is often consulted by the EU on its initiatives and invited to participate to its working groups. CBBA has also a Scientific Committee made up of professors from well-known Universities mainly based in Europe.

Another important mission of CBBA-Europe is to promote cross-border and pan-European benefits arrangements in order to generate economies of scale for employers and providers, and to promote an easier mobility of workers across the EU (and solutions for expats), by overcoming the still existing national barriers between the European Countries

In short, CBBA-Europe is both an advocacy organization and a laboratory of ideas. Its network allows providers, HR and experts to create contacts and possible cooperation.

The Association usually holds 3 events per year: 2 are local, as to say in a specific Country of Europe or in the US, and an annual plenary conference in Brussels at the end of the year, with around 100 participants attending the event.

Summary:

1) Background: why a new legal framework for a pan-European/cross-border occupational pension would be necessary in order to go beyond the existing EU legal framework

Since 2003 the current European legislation allows pension funds (IORPs) to set up cross-border activities. Indeed, according to the EU directives "IORP 1" then replaced by the recent "IORP 2" in 2019, a pension fund based in a given EU member state can manage pension arrangements located in other member states.

However, while the pension vehicle (IORP) is subject to the legislation (in particular the prudential law) of the pension fund, the rules on the pension arrangement (also called "pension plan", or pension scheme") are subject to the national legislation of the state where the employers and workers are normally based (in particular social and labour legislation, but also tax legislation).

The state where the pension fund is based is called the "home state". The state where the employers and workers are normally based, and where the (foreigner) pension fund operates is called the "host state".

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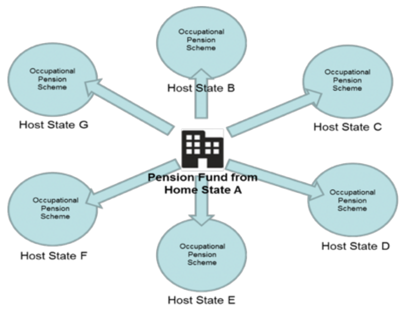
Of course, if the same IORP of the state "A" manages pension arrangements located in several host states "B", "C" and "D", then several jurisdictions would apply at the same time: the prudential law of the state "A", and the social, labour and tax legislations of the host states B, C and D.

In such a context, it is correct to talk about cross-border "activities" of pension funds instead of cross-border or pan-European pensions: pension funds remain national entities and, on their turn, the pension plans/schemes remain subject to their respective jurisdictions.

It is not by chance that all those IORPs operating cross-border activities must set up as many national compartments as the Countries where they do operate in order to comply with national social and labor (and tax) legislations.

Figure 1: Example of "cross-border activities" of pension funds according to the EU existing legislation (IORP directive)



In addition, every time that a cross-border activity is going to be launched, an authorization should be granted by both the national competent authority (NCA) of the state where the IORP is based (home state); and by the NCA where the IORP will be operate (host state).

So far, several IORPs willing to launch cross-border activities in other Countries have experienced problems with the said authorizations, which were (and sometimes still are) too long and burdensome.

Of course, cross-border activities of pension funds are not impossible, and in some cases, they work quite well. However, the said legal requirements and sometimes burdensome bureaucratic tasks still operate to discourage pension providers and sponsoring companies to pursue cross-border activities.

Numbers about cross-border activities are quite clear: after 17 years from the introduction of the first IORP EU directive, there are only 73 active cross-border activities, and almost 50% of them occur between the UK and Ireland (and were even pre-existent to the EU directives).

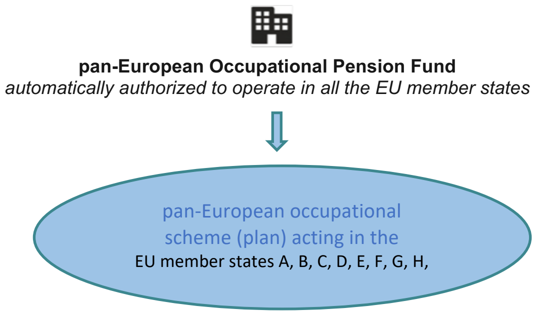
Against this background, <u>CBBA-Europe deems that a new European legal entity, that is, a pension vehicle (IORP) directly designed and regulated by the EU legislation (an EU level IORP)</u> would serve to overcome the existing obstacles to cross-border pensions.

In this perspective, the new Pan-European Occupational Pension (PEOP) would be the corresponding occupational vehicle to PEPP, which is the new recent Pan-European Personal Pension Product created by the EU.

The new PEOP, powered by an EU label, would therefore (almost) automatically operate in all the states of the European Economic Area (EEA). The PEOP would act both as a provider (pension vehicle) and as a plan/scheme.

Easily authorized to operate across the European member state, the new PEOP would not be required to adapt its pension arrangements to the different national jurisdictions. Working on a DC basis, it would therefore operate under the same terms, conditions and protections for workers in all the Countries where it will act.

Figure 2: example of how the new pan-European DC occupational pension should act throughout the European Union.



2) <u>The possible features of the PEOP</u>

A) Voluntary and cohabiting with national pension products (a EU 2nd regime)

Like its corresponding Pan-European product for personal pensions (PEPP), the PEOP would also cohabit with the existing national (occupational/workplace) pensions.

In other words, on the one hand, an employer or a provider (pension funds, insurance company; and also asset managers, if allowed to create occupational pensions in their respective Countries) will be free to offer either a national pension solution, or a PEOP, or both; on the other hand, the existing national occupational pension vehicles will not have to adapt their functioning to the EU legal framework of the PEOP because they will remain independent from the PEOP and will be subject to their national legislations.

This means that the PEOP would be a 2nd EU legal regime.

B) Fully portable across the EU member states

Again, like the PEPP, the PEOP would be fully portable across the different EU jurisdictions: local sub-accounts of the PEOP will be created in all those EU member states where the PEOP will act. In such a way, a worker moving from a Country to another will transfer the pension capitals accrued in his/her previous Country of residence to the sub-account located in new Country of destination. In case a local sub-account is not created in a given Country, the mobile worker (and his/her employer) will be allowed to keep paying pension contributions to the sub-account located in the Country of his/her previous residence.

Portability would be also assured between different PEOPs (as to say PEOPs created by different sponsoring plan companies, or by different pension providers).

C) DC pension product with possibility to offer guaranteed investment options and biometric risks (death, disability, etc.)

The PEOP will work on a DC basis and it might offer a restricted number of investment options. Out of them, like the PEPP, two should offer guarantees on the accrued capitals: one should be an (insured-based) guaranteed investment line; the other should be aim to protect the capital in the long term through risk mitigation techniques by aspiring to recover -at least- the overall contributions paid into the PEOP at the moment of the pay-out phasis.

D) *Solvency, Supervision, Investments, Governance and Information requirements*

- Solvency rules of PEOPs should be the existing sectoral ones referred to the entities that will create PEOPs (pension funds, insurance companies or asset managers). As an example, if an insurance company will create a multi-employer PEOP, that PEOP will be subject to the solvency rules applicable to the pension products offered by the insurers.

- Supervision will be shared between the national authorities of the Countries where the PEOP will operate, and the EIOPA (the European Supervisory Authority).

- Investments, Governance and Information rules will be mainly the same already prescribed by the EU legislation on pension funds (IORP 2 Directive) and PEPPs (PEPP Regulation): no additional rules on investments, governance and information should be imposed by national jurisdictions, in order to avoid a discordant functioning of the PEOP across the different EU member states.

E) *Aspects that might be still regulated by the national jurisdictions (but not undermining the smooth functioning of the PEOP throughout Europe)*

The level of pension contributions might differ among the different Countries where the PEOPs will operate, considering the different wage levels in the EU member states and the different weight of the social security pensions. However, being the PEOP a DC pension product, such differences in pension contributions should not affect the smooth functioning of the PEOP throughout Europe.

The pay-out options (lump-sums, annuities, hybrid formulas) may also differ in the member states. Considering that during the accumulation phase, the PEOPs will keep working homogeneously in the EU, different pay-out formulas would not jeopardize its good functioning.

Also, the retirement age, and hence the determination of the pay-out phasis will remain up to the member states' jurisdictions. Such differences should not affect the functioning of the new pension vehicle during the accumulation phase, because of its DC nature.

Possible early withdrawals of capitals from members (as to say partial or total withdrawals of the capitals invested before reaching the pay-out phasis) are permitted by some national jurisdictions. Such early withdrawals might be permitted by the PEOP too in those Countries, considering again that, because of its DC nature, the overall functioning of the PEOP will remain intact: the member, if allowed by his/her national legislation, will just withdraw part or the entire accrued capital, and his/her personal pension account will deduct this money from the final pension pot.

The possible coverage of biometric risks and guarantees on capitals, if imposed by national legislations, should be offered by PEOPs. However, insofar as such coverages and guarantees will be offered in a given Country, those options should be made available by the same PEOP also in the other EU member states where it will operate. Then, it will be up to the members located in those other member states to decide whether to take them or not.

3) The possible solutions to taxation of PEOPs

Taxation is not a direct competence of the EU, so member states are still free to determine their taxation on pension products. For the PEPP initiative, the EU has recommended (without any binding powers) to member states to tax the PEPPs as they tax their national personal pension products.

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Similarly, if the EU will create a PEOP vehicle, it may recommend treating it fiscally as the national occupational pensions.

However, such a solution might not lead PEOPs to operate homogeneously across the EU, considering that some member states tax also the annual returns on investments (ETT formula, where the first letter is referred to the possible taxation on contributions, the second letter to the possible taxation on returns on investments and the third letter to possible taxation on pension benefits), while others tax the contributions and they exempt both the returns on the investments and the pension benefits (TEE). The most common taxation formula for pension funds in Europe remains the EET: exemption of taxation on contributions and returns on investments, and taxation on the pension benefits.

The PEOP would work most smoothly under a common taxation formula (EET or TEE). In that event, it would be not really relevant "how much" it should be paid to the national tax authorities, but "when" such taxation would be requested. And different tax rules would not have to be applied differently to different national sub-accounts.

The TEE formula (taxation on pension of contributions and then exemptions) would be probably the most interesting formula for both PEOP providers and national tax authorities. PEOPs would immediately pay taxes from pension contributions and transfer them to the different national tax authorities; and Governments would immediately get tax revenue, so that they would not have to be concerned about losing such tax revenue in the event that some employees will then move to other EU member states. The US "Roth 401(k)" has successfully operated in this TEE manner for a number of years.

Taxation could be administered by the creation of a centralized taxation entity, like an agency acting as a "tax hub". Such an entity may have mere tax information purposes for PEOP providers, or even functional/operating purposes, such as fulfilling the tax obligations of PEOP providers during the accumulation phase.

In the first case (a centralized EU taxation agency with information purposes), all the PEOPs would outsource to the EU taxation tool the calculation of the annual tax amounts. Once that the information on the amounts to be paid will be sent by EU taxation agency to the different PEOP providers, those latter will just make the payments to the different tax authorities.

In the second case (EU centralized taxation agency with operational purposes), such a centralized European tax would be entrusted with collecting directly the tax amounts due from PEOP providers on an annual basis; and with refunding the respective national tax authorities. In other words, the European tax agency may act as a buffer allowing the PEOPs to operate throughout the EU *as if* a common tax formula was in place for them.

Conclusions

If well designed, based on an utmost transparency and simplicity and protections for both beneficiaries and sponsoring companies, a pan-European DC Occupational Pension (PEOP) may have beneficial results for actors living and/or operating in Europe, and could contribute to other EU goals.

- Large employers (multinational companies) would finally make big savings in managing their workplace pensions across Europe. Economies of scale, centralization of governance, common administration and investment policies, mergers and reduction of local/national occupational pensions schemes/plans, valid solutions in case of corporate cross-border transfers of employees in Europe, would represent an important added value for multinationals employing workers in several EU member states;

- The occupational pensions' coverage might significantly increase, as several employers could be more motivated to offer a cost-efficient tool to their employees even in those EU Countries where occupational pensions are not strong or almost do not exist. This advantage would be particularly strong for small and medium enterprises (SMEs), which are often limited in offering occupational pensions to their employees because of the costs and/or lack of adequate offer of open pension funds. In particular, multi-employer pensions platforms (multi-employer IORPs) located in other EU member states and allowed to operate in several Countries might offer cheaper occupational pension solutions to several employers, including SMEs. Increasing the workplace pensions' coverage is in fact one of the main goals of the EU;

- As for the **members/beneficiaries**, in addition to the said accrued chances of getting enrolled in a workplace pension that they would have otherwise never got, the creation of economies of scale, lower administration costs and a simple design of the tool would potentially increase their future retirement income, by granting a better pension adequacy, which is another main goal of the EU in the field of pensions. Moreover, they might take advantage of portability of their pension rights across the EU member states;

- Mobility of workers (both at infra-corporate or inter-corporate level) would be favored at the advantage of both the sponsoring undertakings and the members, insofar as the same PEOP (fully portable) acting in several Member States of the EU would cover those mobile workers. Multinational companies employing people in European Countries would be finally free to transfer their employees over their national branches located in the European Economic Area, by keeping them enrolled in the same corporate pension (infra-corporate mobility). The removal of the obstacles deriving from mobility of workers in Europe would contribute to a better pension income of the future beneficiaries –as opposed to a fragmentation of their pension positions in every Country where they did work-, and significant savings for those sponsor companies operating in several EU member states.

- Several actors of the pension industry such as pension funds/IORPs (including multi-employer IORPs), insurers, asset managers, auditors, advisors, pensions' administrators, etc., would finally get several advantages coming from the creation of a real European internal market of pensions. Europe could become the wealthiest and most competitive pension market in the World.

- Accumulation of great amounts of assets collected by pan-European Occupational Pensions would contribute to the **completion of the EU Capital Market Union**, and would also favor investments in the so called "real economy" (i.e. Infrastructures; PPPs, financing of companies; etc.) by reducing the predominant role of the banks, which still remain by far the main lenders in Europe.

Social goals such as a wider coverage and better adequacy of pensions could walk hand in hand with the European economic fundamental freedoms (mobility of workers, capitals and services), and more in general, would lead to an accrued economic competitiveness of the Union.

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