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signed by Mr Jordi AYET PUIGARNAU, Director

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To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of  
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Accompanying the document Proposal for a REGULATION OF THE  
EUROPEAN PARLIAMENT AND OF THE COUNCIL on a pan-European  
Personal Pension Product (PEPP) and COMMISSION  
RECOMMENDATION on the tax treatment of personal pension products,  
including the pan-European Personal Pension Product

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Delegations will find attached document SWD(2017) 243 final.

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Brussels, 29.6.2017  
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**COMMISSION STAFF WORKING DOCUMENT**

**IMPACT ASSESSMENT**

*Accompanying the document*

**Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE  
COUNCIL**

**on a pan-European Personal Pension Product (PEPP)**

**and**

**COMMISSION RECOMMENDATION**

**on the tax treatment of personal pension products, including the pan-European Personal  
Pension Product**

{COM(2017) 343 final}  
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## 1. INTRODUCTION AND POLICY CONTEXT

The case for an EU personal pension initiative must be assessed in the broader context of efforts to build a Capital Markets Union (CMU). The CMU is part of the third pillar of the Commission's Investment Plan for Europe and is key to delivering the Juncker Commission's priority to boost jobs and growth. The CMU seeks to facilitate the flow of savings to investment and removing obstacles to the free flow of capital across borders. This would strengthen the European financial system by enhancing private risk-sharing, providing alternative sources of financing and increasing options for retail and institutional investors. A stronger capital market as a result of the CMU is in turn expected to provide individuals with better options to meet their retirement goals, delivering better outcomes for savers and providers alike.

In its Action Plan on Building a Capital Markets Union<sup>1</sup>, the Commission observed that no effective single market for 'third pillar' personal pensions exists. A patchwork of rules at EU and national levels stands in the way of the full development of a large and competitive market for personal pensions. Market fragmentation prevents personal pension providers from maximising economies of scale, risk diversification and innovation, thereby reducing choice and increasing cost for pension savers. In addition, existing personal pension products display in some cases insufficient product features. Finally, cross-border selling and portability of existing personal pensions are very limited.

For the purpose of this impact assessment, personal pension products (PPPs) are defined as retirement financial products which:

- are based on a contract between an individual saver and a non-state entity on a voluntary basis, with an explicit retirement objective;
- provide for capital accumulation until retirement, and where the possibilities for early withdrawal are limited,
- provide an income on retirement.

PPPs should complement state-based pensions and, where they exist, occupational pensions stemming from employment relationships. Public and occupational pensions are not covered by the scope of this initiative (see the Box below).

### **Box 1 – State-based, occupational and personal pensions and some examples of personal pensions**

As explained in the 2014 "Pension Scheme" study for the EMPL Committee commissioned by the European Parliament<sup>2</sup>, a detailed comparison of pension systems across Member States is a difficult task. All Member States have set up pension systems whereby workers are assured of a certain level of income upon their retirement, and the design of the pension system remains a national prerogative. The elements of the pension system are:

- a first pillar consisting of "**state-based pensions**", which are part of a public statutory social security system (mostly financed through taxes or social contributions, therefore classified as pay-as-you-go systems)

<sup>1</sup> COM(2015) 468 final.

<sup>2</sup> Study on Pension Schemes, study for the EMPL Committee, 2014, available at: [http://www.europarl.europa.eu/RegData/etudes/STUD/2014/536281/IPOL\\_STU\(2014\)536281\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2014/536281/IPOL_STU(2014)536281_EN.pdf)

- a second pillar consisting of "**occupational pensions**" or "second pillar pensions" i.e. financial institutions which manage collective retirement schemes for employers, in order to provide retirement benefits to their employees (the scheme members and beneficiaries)<sup>3</sup>;
- a third pillar consisting of "**personal pensions**", "**PPPs**" as in the impact assessment or "third pillar pensions" i.e. non-compulsory private pension savings by individuals;

There is no agreed unique taxonomy of pension systems, and organisations such as the World Bank, EIOPA, or the OECD isolate more specific features beyond the broad definitions provided above. Moreover, as the terms second and third pillars have different meanings in Member States depending on the design of their national pension systems (e.g. in some Member States, "second pillar" denotes statutory funded pensions, while occupational pension schemes are considered part of the "third pillar") throughout the report we will use the terms "occupational" and "personal" pensions instead of pillars.

EIOPA advice provides an indication of the specific features of PPPs and differences with other types of investment products:

- The specific aim of PPPs is to provide an income to PPP savers after retirement;
- PPPs provide capital accumulation from the mid to long term until the (expected) retirement age and may also cover biometric risks;
- During the accumulation phase premiums and contributions are deferred to a private entity, the PPP provider;
- During the accumulation phase the possibility for early withdrawal of the accumulated capital is limited and often sanctioned;
- National legislation could sometimes restrict the ways in which the accumulated PPP capital can be used upon retirement (e.g. (lifelong) annuitisation, programmed withdrawal, (partial) lump sums).

From an economic point of view, investments in (long duration and safe) government bonds and real estate could be considered as substitute products. However, notwithstanding the risks stemming from potential property market crisis, PPPs provide the advantages of divisibility<sup>4</sup>, i.e. the possibility to invest small amounts on a regular basis and portfolio diversification.

Examples of current PPPs include:

- the Pension savings plan in Belgium ("Pensioensparen"), mainly sold by banks and insurers, which offers an investment option between savings funds (aggressive, defensive or balanced strategy) and a guaranteed interest product. Decumulation must normally start after 60 years. This plan is subject to a tax relief of 30% of the contribution, up to a limit of contribution of EUR 940 per year (in 2016).

<sup>3</sup> Occupational and personal pensions are generally referred to as "second pillar" and "third pillar" pensions, respectively, however the actual meaning of those terms varies depending on the design of the national pension system (in some Member States, "second pillar" denotes statutory funded pensions, while occupational pension schemes are considered part of the "third pillar"). Therefore, this report uses the terms "occupational" and "personal" pensions. Together they are known as "supplementary pensions".

<sup>4</sup> Divisibility refers to the smallest denomination in which an asset is traded. For example a bank savings deposit account in which an investor can invest as little as one euro cent, is a perfectly divisible security in contrast to corporate or government investments where minimum investment amounts can be very large.

- the Riester Rente in Germany, mainly sold by banks, brokers and insurers, including online. Investment options include more aggressive strategies (e.g. fund-linked pension insurance), or more defensive ones (e.g. bank saving plans). Decumulation must start after age 62. This plan is subject to a tax relief on contributions with a maximum amount of 2100 EUR per year.

As announced in the Action Plan on Capital Markets Union in September 2015<sup>5</sup>, "*an 'opt in' European Personal Pension could provide a regulatory template, based on an appropriate level of consumer protection, that pension providers could elect to use when offering products across the EU. A larger, 'third pillar' European pension market would also support the supply of funds for institutional investors and investment into the real economy*". Consequently, the Commission announced that it will "*assess the case for a policy framework to establish a successful European market for simple, efficient and competitive personal pensions, and determine whether EU legislation is required to underpin this market*".

In its Resolution of 19 January 2016, the European Parliament expressed concern<sup>6</sup> about the lack of available and attractive risk-appropriate (long-term) investments and cost-efficient and suitable savings products for consumers. Whilst reiterating the need for diversity in investor and consumer choices, the European Parliament stressed that "*an environment must be fostered that stimulates financial product innovation, creating more diversity and benefits for the real economy and providing enhanced incentives for investments, and that may also contribute to the delivery of adequate, safe and sustainable pensions, such as, for example, the development of a Pan-European Pension Product (PEPP), with a simple transparent design*".

In June 2016, the European Council adopted an agenda calling for "*swift and determined progress to ensure easier access to finance for business and to support investment in the real economy by moving forward with the Capital Markets Union agenda*"<sup>7</sup>.

In September 2016, in its Communication on Capital Markets Union – Accelerating Reform<sup>8</sup>, in light of the strong support expressed by the European Parliament, Council and stakeholders to the CMU Action Plan, the Commission announced as a next step developing further priorities, that it will "*consider proposals for a simple, efficient and competitive EU personal pension product*".

Consequently, in its Communication on the Mid-Term Review of the Capital Markets Union Action Plan, the Commission announced "*a legislative proposal on a Pan-European Personal Pension Product (PEPP) by end June 2017. This will lay the foundations for a successful market in affordable and voluntary retirement-related investments that can be managed on a pan-European scale. It will meet the needs of people wishing to provision for retirement, address the demographical challenge, complement the existing pension products and schemes, and provide a powerful new source of private capital for long-term investment*"<sup>9</sup>.

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<sup>5</sup> COM(2015) 468 final.

<sup>6</sup> European Parliament, Resolution of 19 January 2016 on stocktaking and challenges of the EU Financial Services Regulation: impact and the way forward towards a more efficient and effective EU framework for Financial Regulation and a Capital Markets Union, <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P8-TA-2016-0006&language=EN>

<sup>7</sup> European Council Conclusions of 28 June 2016, EUCO 26/16, point 11.

<sup>8</sup> COM (2016) 601 final, p. 4.

<sup>9</sup> COM(2017) 292 final, p. 6.

Accordingly, this impact assessment<sup>10</sup> aims to support the process of taking a well-informed decision on the legislative initiative on a PEPP.

In this regard, a PEPP framework would entail a complementary voluntary regime beside national regimes, allowing providers to create personal pension products on a pan-European scale.

A PEPP framework would contribute to progress towards a single market for personal pensions, by harmonising a set of core product features and facilitating cross-border activity.

The PEPP framework would bring value added as compared to existing PPPs, building on existing best practices complemented by specific features conferring it a pan-European dimension. First, the PEPP could be offered by a wider range of providers than existing PPPs, including not only insurance companies (currently the major players in personal pensions) but also investment firms and asset managers, as well as specialised pension funds (currently more focussed on occupational pensions). It would be authorised by the European Insurance and Occupational Pensions Authority (EIOPA), on the basis of a single set of rules and once authorised could be marketed across the European Union.

PEPP providers would follow specific rules on distribution ensuring adequate information and checks.

The PEPP would be a simple product, with a limited set of investment options. It would include the right to switch provider and the possibility to continue contributing to the same product when exercising mobility across the European Union. The PEPP framework would provide a safe default investment option. It would be innovative – distributed on an electronic basis – and transparent, with appropriate disclosure of all costs and fees. Prospective PEPP savers would receive appropriate information via a PEPP Key Information Document before the conclusion of the contract, as well as information on their pension benefits during the term of the contract.

Subject to the effective development of PEPPs, the PEPP framework could mobilise over time some additional households' savings e.g. from deposits towards investments on capital markets. Even if the development of a PEPP would be progressive and additional investments on capital markets limited, as a long-term savings product, matched by long-term investments, the PEPP framework could contribute to the objectives of CMU.

Against this background, the Commission has organised a public consultation (including a public hearing) on EU personal pensions and received 585 contributions from a broad range of stakeholders (*see a synopsis of the consultative work and a detailed analysis of the public consultation, in Annex 2*). The responses showed a strong interest from private individuals in simple, transparent and cost-effective PPPs. The public consultation also requested feedback from professionals on the feasibility of an EU personal pension framework including a PEPP. As national tax incentives are an important driver for the take-up of personal pension products, the Commission has commissioned a study on a European Personal Pension Framework (the "EPPF Study" hereafter)<sup>11</sup> in order to map the national tax and other legal requirements applicable to personal pensions on the basis of a set of personal pension

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<sup>10</sup> See Annex 1 for the procedural information concerning the process to prepare the Impact Assessment report and related initiative.

<sup>11</sup> FISMA/2015/146(2)/D4/ST/OP - Study on European Personal Pension Framework, by Ernst and Young.

products, evaluate the market potential for personal pensions across the EU and assess the feasibility for stakeholders to implement an EU personal pension framework<sup>12</sup>.

This impact assessment builds *inter alia* on substantial technical advice from the European Insurance and Occupational Pensions Authority (EIOPA)<sup>13</sup> on the development of an EU single market for personal pension products ("EIOPA technical advice" hereafter). This advice itself builds on an earlier preliminary report of EIOPA, entitled "Towards a single market for personal pensions"<sup>14</sup>. The selected policy options in this impact assessment are in line with the EIOPA technical advice on the key issues, particularly the choice of a PEPP against other general policy options (section 4.1), and the determination of key features (section 4.2).

This impact assessment also builds on the work carried out by the OECD in the area of private pensions. First, the work on tax treatment of personal pensions products, namely the OECD study on "Stocktaking of the Tax Treatment of Funded Private Pension Plans in OECD and EU countries"<sup>15</sup> and the Commission-OECD project on Taxation, Financial Incentives and Retirement Savings<sup>16</sup>. Second, the impact assessment takes guidance from the OECD Study "Core Principles of Private Pension Regulation"<sup>17</sup> on the design and operation of private pension systems. Finally, the impact assessment also takes into consideration the Oxera Study on the position of savers in private pension products across fourteen Member States<sup>18</sup>.

Based on these various inputs, the next section presents the main problems and shortcomings of the personal pensions market.

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<sup>12</sup> The draft final report is expected in May, and the final report in June 2017.

<sup>13</sup> EIOPA's advice on the development of an EU Single Market for personal pensions products (PPP), July 2016, available at:

<https://eiopa.europa.eu/Publications/Consultations/EIOPA%27s%20advice%20on%20the%20development%20of%20an%20EU%20single%20market%20for%20personal%20pension%20products.pdf>

<sup>14</sup> EIOPA, Towards an EU single market for personal pensions, 2014, available at:

[https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-029\\_Towards\\_an\\_EU\\_single\\_market\\_for\\_Personal\\_Pensions-An\\_EIOPA\\_Preliminary\\_Report\\_to\\_COM.pdf](https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-029_Towards_an_EU_single_market_for_Personal_Pensions-An_EIOPA_Preliminary_Report_to_COM.pdf)

<sup>15</sup> OECD study on "Stocktaking of the Tax Treatment of Funded Private Pension Plans in OECD and EU countries", available at <http://www.oecd.org/pensions/Stocktaking-Tax-Treatment-Pensions-OECD-EU.pdf>

<sup>16</sup> Available at: <http://www.oecd.org/daf/fin/private-pensions/financial-incentives-retirement-savings.pdf>.

<sup>17</sup> Available at:

<http://www.oecd.org/daf/fin/private-pensions/Core-Principles-Private-Pension-Regulation.pdf>

<sup>18</sup> <http://www.oxera.com/Latest-Thinking/Publications/Reports/2013/Study-on-the-position-of-savers-in-private-pension.aspx>

## 2. PROBLEM DEFINITION

The main problems identified in this impact assessment concern the following issues: (1) the fact that the further development of the Capital Markets Union (and long-term investments) is, together with other elements out of scope of this impact assessment, affected by the low level of personal savings in retirement products by households (2) insufficient features of personal pension products; (3) cross-border problems, including the lack of a genuine internal market for personal pensions products within the EU.

### 2.1. Underdeveloped capital markets in the Capital Markets Union context

The personal pension market in the EU is currently under-developed, highly fragmented and with low cross-border sales (see below and in the following sections). Together with many other elements outside the scope of this impact assessment, this affects the completion of the Capital Market Union which aim is, inter alia, to increase the depth and liquidity of capital markets and their efficiency, ultimately benefitting investment and growth in the EU. More details about the economic benefits of developed capital markets can be found at the end of this section.

The EU actions in order to complete the CMU cover, many other areas beyond personal pensions. The CMU Action Plan sets a broad policy agenda which aims to put in place a structural reform to strengthen European capital markets and reduce the dependency of the European economy on bank lending.

Within all the projects covered under the CMU Action Plan, personal pensions (and more broadly pension funds) play a role as major institutional investors on capital markets. In this context, the EU is lagging behind compared to other advanced economies: as shown in the table below the total investment assets by pension funds (as per OECD definition) in the EU is at around 30% of GDP compared to 79% in the US for example.

**Table 1: Total investment assets as per OECD definition of pension funds - Billions USD**

World	2005	2015	weight	Increase 2005/2015	as a % of GDP 2015	GPD 2015 IMF
United States	9,711	14,250	56%	47%	79%	18,037
Total EU27 (no Cyprus)	3,110	5,058	20%	63%	31%	16,307
Japan	1,316	1,327	5%	1%	30%	4,382
Canada	687	1,196	5%	74%	77%	1,553
Switzerland	413	793	3%	92%	118%	671
Rest of the world	1,141	2,931	11%	157%		
Total - World	16,378	25,554	100%	56%	34%	74,197

*Source: OECD, IMF, own calculations*

The currently sub-optimal level of savings in personal pensions and the relatively high level of savings in the form of deposits reduce the potential investment flows by households into capital markets. As a matter of fact, households are the main providers of net funding in the economy with, as of December 2015, almost EUR 34 trillion of total financial assets and a saving rate of more than 10% of gross household disposable income in the EU, equivalent to

EUR 1 trillion<sup>19</sup> in 2015. The table below shows the amounts for the main financial asset categories held by households at December 2015 in all Member States, ranked from the State with the highest level of total financial assets over GDP to the lowest level (data taken from Eurostat). The last column instead gives an estimation of personal pension assets under management in the countries where data was available<sup>20</sup>.

**Table 2: Overview of Households Financial Assets and Personal Pension Market by Member State, EU 28**

Households Financial Assets (2015 except for PP Market 2014)	Total financial assets (% GDP)	Total financial assets (TFA) (EUR Billion)	Currency & deposits (EUR Billion)	Currency & deposits (% of TFA)	Occupational pension entitlements (EUR Billion)	Life insurance and annuity entitlements (EUR Billion)	Personal Pension Market (EUR Billion)	Personal Pension Market (% TFA)
Netherlands	325%	2,195	409	19%	1,317	139	9.7	0.4%
United Kingdom	324%	8,262	2,006	24%	4,024	825	No data	N/A
Belgium	309%	1,266	373	29%	80	179	43.4	3.4%
Denmark	294%	799	133	17%	171	216	78.8	9.9%
Sweden	281%	1,280	179	14%	379	112	11.0	0.9%
Cyprus	259%	46	29	63%	4	2	Low PPP	N/A
Malta	257%	24	11	46%	0	2	2.1	9.0%
Italy	251%	4,120	1,273	31%	251	574	37.2	0.9%
France	222%	4,841	1,379	28%	0	1,665	49.9	1.0%
Portugal	212%	380	168	44%	22	47	2.3	0.6%
Spain	187%	2,009	848	42%	165	149	83.5	4.2%
Austria	182%	620	252	41%	40	73	8.1	1.3%
Germany	182%	5,503	2,153	39%	786	920	215.1	3.9%
Greece	148%	259	172	66%	3	6	Low PPP	N/A
Finland	144%	301	90	30%	24	28	12.0	4.0%
Luxembourg	140%	72	36	50%	2	9	No data	N/A
Ireland	139%	356	132	37%	116	44	4.7	1.3%
Bulgaria	135%	61	23	38%	5	1	0.2	0.3%
Hungary	124%	133	38	28%	5	6	3.5	2.6%
Croatia	121%	53	29	55%	10	2	0.3	0.7%
Estonia	113%	23	7	29%	3	0	0.3	1.5%
Czech Republic	110%	186	97	52%	13	10	11.4	6.2%
Latvia	108%	26	9	34%	3	0.2	0.3	1.1%
Slovenia	102%	39	20	50%	3	3	1.9	4.8%
Poland	97%	408	195	48%	37	18	0.9	0.2%
Lithuania	92%	34	12	36%	2	1	0.05	0.1%
Slovakia	77%	61	38	62%	8	4	1.5	2.4%
Romania	72%	114	40	35%	6	1	0.2	0.2%
<b>Total</b>	<b>228%</b>	<b>33,470</b>	<b>10,149</b>	<b>30%</b>	<b>7,479</b>	<b>5,037</b>	<b>578*</b>	<b>2.3%*</b>

Source: Eurostat and EPPF Study and own calculations. \*The totals for the last two columns are for 24 Member States

In terms of financial instruments, cash and deposits represent around 30% of the total with an amount of more than EUR10 trillion which is equivalent to almost 70% of the EU GDP. The amount held in deposits is quite lower (below 20% of total assets) than the EU average for three Member States (Netherlands, Denmark and Sweden) as the life insurance and occupational pensions markets are quite developed. However, for twelve Member States the currency and deposits account for more than 40% of total financial assets; for seven of them the level is higher or equal than 50% showing a low level of diversification of households' financial portfolio.

<sup>19</sup> EUR961 billion as the sum of four quarters in 2015 of "gross saving" defined by Eurostat as the portion of gross disposable income that is not used for final consumption expenditure.

<sup>20</sup> For Cyprus and Greece the current personal pension market is not developed. As per EIOPA Consultation paper on the creation of a PEPP, the assets under management in Luxembourg and the United Kingdom amounted to respectively of EUR0.5bl (as of December 2011) and EUR237bl (as of December 2010). However the definition of PPP employed by EIOPA is less stringent as it includes mandatory retirement products and as such figures are not fully comparable.

The higher propensity to prefer deposits over other financial products is more pronounced for households with lower financial assets. Table 2 shows that the total assets under management (AuM) of PPPs for which data was available are estimated at 578 billion EUR for 2014. This represented less than 3% of European households' financial assets. This can be considered as low, especially as compared to cash and deposits.

According to the EIOPA technical advice, only 67 million people, out of a total EU population of 243 million between 25-59 years old (27% of the total) are currently voluntarily subscribed to financial products with a long-term pension objective. These are concentrated primarily in a few markets (Netherlands, United Kingdom, Czech Republic, Belgium and Spain)<sup>21</sup>.

A recent survey carried out by the ECB<sup>22</sup> in the euro-area Member States points out that the smallest financial asset portfolios consist almost exclusively of deposits (for example, for the first four deciles of total financial assets, deposits account for more than 80% with the remainder consisting mainly of life insurance policies/voluntary pensions). Savings in the form of other financial instruments are concentrated among wealthier households: the wealthier the household, the more diversified its asset portfolio, and the more educated the household, the higher the share of other assets (e.g. for the top 10% of portfolios, voluntary pensions/life insurance products account for 25%, and risky assets for 26%). Moreover, the current low level of investments and participation by households in pension products has a negative impact on the size and the diversity of participants in capital markets.

The long-term nature of pension products liabilities incentivises providers to invest more in illiquid and long-term assets that yield higher returns. To the extent they invest in equity and corporate bond markets, they provide a long-term supply of funds to capital markets, and thus may contribute to their development.

Taking the pensions funds' assets<sup>23</sup> as proxy, empirical evidence shows that their size has an impact on the development of capital markets especially on the stock market capitalization. Pension funds are indeed an important source of funding, and affect the amount of market financing available and the efficiency of financial intermediation. They provide an alternative savings vehicle for households and add to competition on the loan and securities markets. In so doing, they spread the gains of investments in capital markets to the broader population, facilitate asset diversification, and make the access to capital markets cheaper. Countries with an important pension funds sector tend to have larger capital markets<sup>24</sup>. For example, after World War II many European countries rebuilt their pension system by establishing a pay-as-you-go system, whereas pension funds became an important provider of funds on the US capital market<sup>25</sup>. This led to significant differences in the amount of savings made available for investment in financial securities. A regression analysis performed by the Commission services<sup>26</sup> found that by increasing pension assets in the euro area and the EU by respectively 73% and 60% of GDP (i.e. to the levels observed in the US around 90% of GDP), this would

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<sup>21</sup> EIOPA technical advice. 2014, EIOPA BoS Preliminary Report to the Commission.

<sup>22</sup> ECB – The Household Finance and Consumption Survey: Second Wave (December 2016). <https://www.ecb.europa.eu/pub/pdf/scpsps/ecbsp18.en.pdf>

<sup>23</sup> They also have a long-term horizon regarding investments with debt and equity representing the largest share in their investment allocation.

<sup>24</sup> See, for example, Rocholl and Niggemann (2010), Meng and Pfau (2010).

<sup>25</sup> For example, the amount of investments in listed and unlisted shares of US insurance companies and pension funds stood at EUR 6 trillion as of end 2014, which was three times as much as the level of their European counterparts – see *Europe's untapped capital market*, Diego Valiante (2016), p. 79.

<sup>26</sup> EFSIR 2016 – European Commission.

generate an additional stock market capitalisation of 31% and 26% in the euro area and EU respectively.

Moreover, as described in some research papers<sup>27</sup> *"even in the case that pension savings crowd out other household savings such that the total savings in the economy do not increase, the accumulation of pension fund assets is expected to potentially promote depth and liquidity in the capital markets because of the different investment behaviour between households and pension funds. Other potential impacts from the growth of pension funds include an inducement toward financial innovation, improvement in financial regulations and corporate governance, modernization in the infrastructure of securities markets, and an overall improvement in financial market efficiency and transparency"*.

In conclusion, the insufficient provision of simple, cost-effective, transparent and trustworthy personal pension products affects the development of non-bank funding alternatives for companies and longer-term investment, as well as additional risk diversification opportunities for households. The economic benefits of capital markets<sup>28</sup> are multiple and can be summarized as follows:

- **Deep, liquid and efficient capital markets bring advantages to borrowers and investors.** They have three main advantages for companies seeking finance: (i) improve their access to funds; (ii) reduce their capital costs by creating competition among investors; and (iii) reduce the risk of disruption in financing by diversifying their funding sources. On the investors' side, by increasing the investment opportunities, efficient capital markets offer investors a broader set of financial products to (i) meet their investment objectives, (ii) diversify and manage their risks, and (iii) optimise their risk-return profile, while respecting their investment constraints – whether in terms of risk, duration, or other assets' characteristics. Overall, capital markets (especially equity markets) facilitate entrepreneurial and other risk-taking activities, which have a positive effect on economic growth.
- **Large and well-integrated capital markets can contribute to jobs and growth** through a number of channels. They can contribute to allocative efficiency by opening up investment and diversification opportunities for investors across Europe, improving access to risk capital for borrowers, and allowing greater competition (unleashing corresponding benefits such as productivity gains, lower costs, greater choice, financial innovation, etc.). Portfolio diversification possibilities should also be enhanced because the larger financial markets are and the better they are integrated across borders, the more opportunities they allow to share risks among actors and economies.
- Moreover the **optimal financial structure shifts towards capital markets along with higher levels of economic development.** Banks are particularly well-placed to serve economies at an early stage of development. They also have an uncontested role in certain market segments, for example to provide funding to firms that are too small to tap market sources. Capital markets take longer to develop because they require

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<sup>27</sup> See, for example, "Pension Funds, Retirement-Income Security and Capital Markets, an International Perspective" (Davis, 1995) and "The Role of Pension Funds in Capital Market Development" (Pfaü WadeGRIPS and Channarith Meng), GRIPS Policy Research Center 2010, [http://www.grips.ac.jp/r-center/en/discussion\\_papers/10-17/](http://www.grips.ac.jp/r-center/en/discussion_papers/10-17/)

<sup>28</sup> See "Economic analysis accompanying the Action Plan on Building a Capital Markets Union" – European Commission (SWD(2015) 183 final) and the relevant cited academic papers therein.

extensive technical and legal infrastructures (e.g. clearing, settlement, information provision). Services provided by financial markets become comparatively more important for higher-income Member States because, when economic and institutional systems mature, demand for a broader set of risk management and capital raising tools increases beyond what banks can typically supply.

## **2.2. Insufficient features in the area of personal pension products**

Currently, personal pension products are regulated at national level as further described in Section 2.3. This results in a diverse set of product features and a lack of portability. Many respondents to the public consultation view the supply of personal pension products currently available and sold in the EU as insufficient. These views are supported by the 2015 European Commission scoreboard on retail investor markets<sup>29</sup>, which shows that personal pension products are indeed among the three products with the lowest satisfaction rating from retail investors. This low ranking reflects the potential for improvement of performance of personal pensions in terms of comparability and choice of product features and choice of providers.

In addition, there is insufficient diversity in the provision of PPPs. This further affects the supply of certain product features.

### *2.2.1. Personal pension product features*

Some of the concerns on the quality of existing personal pension products, as highlighted in the public consultation and the EIOPA technical advice, are presented in more detail below. These concerns limit the attractiveness of some existing PPPs for savers.

#### *(a) Disclosure of information*

In its technical advice<sup>30</sup> EIOPA considers that information asymmetries between providers and customers reduce trust in personal pension products. As savers are less well informed than PPP providers, they have difficulty judging or comparing the performance and quality of the pension product and providers. This information asymmetry has the potential to result in sub-optimal decision making by savers on PPPs and could lead to less cost-effective and unintended outcomes for PPP holders.

Consumer organisations indicated in the public consultation that in some cases information on fees and costs is opaque and disclosed in a non-aggregated manner, especially in the case of multi-layer products. For consumer organisations, the information provided on returns is often incomplete and does not indicate the net return (taking into account all taxes and fees) that the pension saver will effectively receive. Some consumer organisations indicated that PPP

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<sup>29</sup> The Consumer Market Monitoring Survey allows ranking markets on the basis of the ‘Market Performance Indicator’ (MPI) — a composite index taking into account five key aspects of consumer experience. The components of the index are weighted on the basis of their relative importance as stated by consumers and the maximum total score is 100. The score of private pensions in the Market Performance Indicator (MPI) is 74,1 compared to 78.5 for all services markets., European Commission study, Monitoring consumer markets in the European Union 2015, page 100, available at: [http://ec.europa.eu/consumers/consumer\\_evidence/consumer\\_scoreboards/market\\_monitoring/docs/mms2015\\_final\\_report\\_part\\_iii\\_en.pdf](http://ec.europa.eu/consumers/consumer_evidence/consumer_scoreboards/market_monitoring/docs/mms2015_final_report_part_iii_en.pdf);

<sup>30</sup> See page 11.

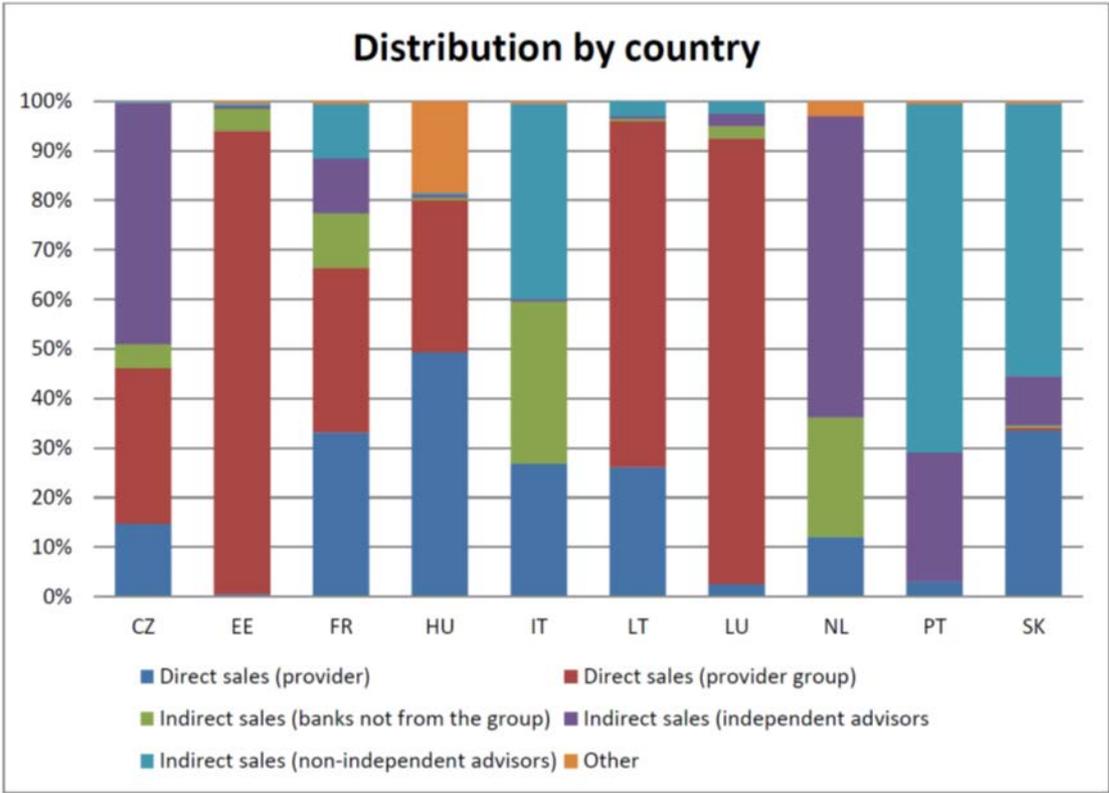
customers of life insurers are not sufficiently informed about the total amount of the benefits they are likely to receive on retirement, even if an annual information sheet is provided by the insurer. The information provided is often not comprehensive and does not include the expected future benefits or how an annuity product would evolve over time.

*(b) Distribution of PPPs*

One way of overcoming information asymmetries of PPPs for savers is to make use of independent advisors or compare products features through online distribution. However, EIOPA concludes that the current distribution model of PPPs takes place through existing distribution channels, either directly by the provider or through non-independent intermediaries<sup>31</sup>.

Figure 1 below shows limited use, in the Member States surveyed, of independent advisors (except for Czech Republic and Netherlands) or online sales (captured under "other", mainly in Hungary). Absence of advice or inability to compare products online can increase risks of miss-selling.

**Figure 1. Distribution of PPPs per Member State, for ten Member States**



Source: EIOPA technical advice

*(c) Diverse levels of net performance after costs and charges*

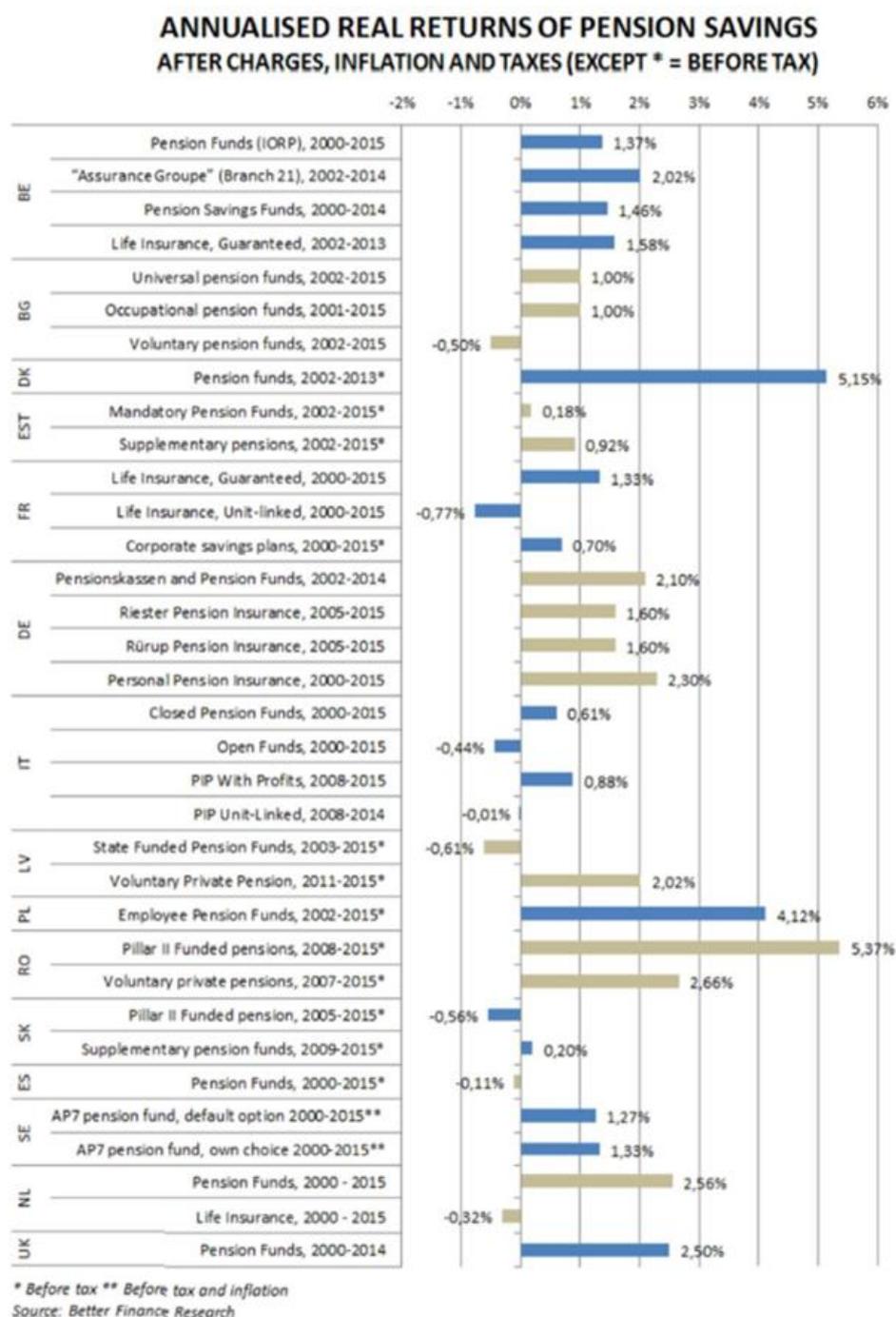
<sup>31</sup> EIOPA technical advice, section 2.3., p. 39-46.

The Better Finance Study on Pensions Savings – The Real Return<sup>32</sup> shows very diverse levels of net performance after costs and charges for PPPs in a series of Member States. The low returns of PPPs in some Member States undermine attractiveness of saving for retirement through PPPs. As shown in Figure 2 below, Spanish, some French, Italian and Bulgarian PPPs provided on average negative real returns in the period 2000-2015. In most Member States, the average net return of some PPPs is just above the inflation rate. The study identified net returns clearly above inflation only in some Member States (the Polish and Danish pension products providing yearly net real returns above 4%).

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<sup>32</sup> Available at:  
[http://betterfinance.eu/fileadmin/user\\_upload/documents/Research\\_Reports/en/Pension\\_Report\\_2015\\_For\\_Web.pdf](http://betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/Pension_Report_2015_For_Web.pdf)

Figure 2. Net real performance of pension funds (occupational and personal), in different Member States, from 2000 onwards



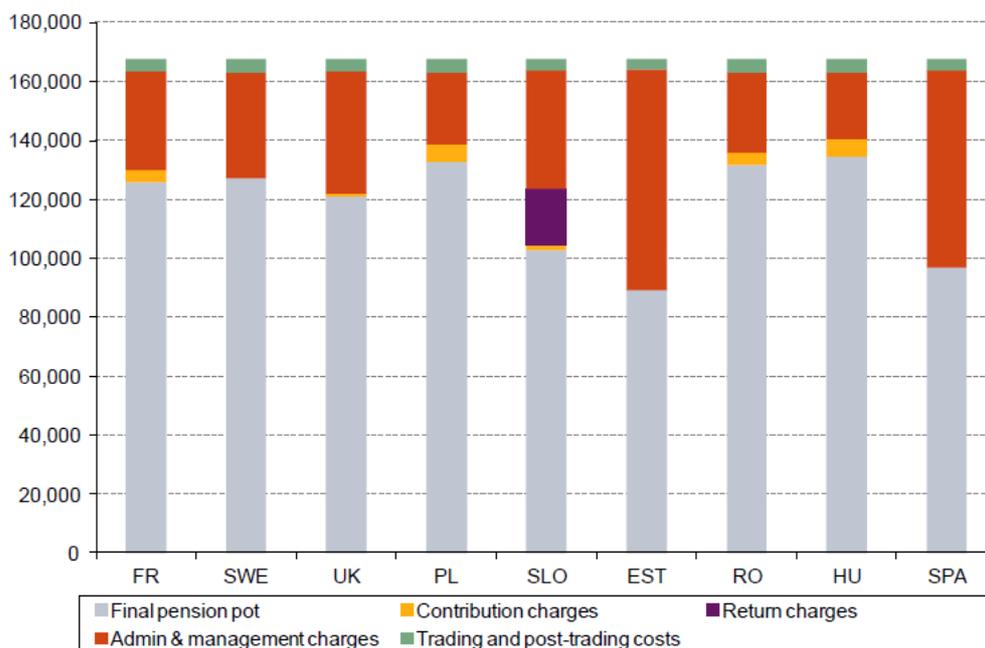
Evidence suggests that charges and costs of PPPs are one of the causes of negative or low real net returns. As an example, COVIP<sup>33</sup>, the Italian supervisor of pension funds publishes every year an aggregate cost index<sup>34</sup> of personal pensions sold in Italy. For 2016, the average yearly costs (calculated over a 10 year period and assuming investments of annual EUR 2500 and annual return of 4%) are quite high: from 1.1% to 2.7% depending on the type of investment strategy. As shown in Figure 3 below, the charges can take away a considerable amount of a pension pot. Furthermore, as outlined in section 2.1.2 a) above, fees are often relatively

<sup>33</sup> Commissione di Vigilanza sui Fondi Pensione

<sup>34</sup> Available at: <http://www.covip.it/?cat=199#>

opaque, making it more difficult for savers to compare costs and charges of distinct products and providers.

**Figure 3 - Reduction in yield through charges in some Member States – Oxera Report 2013**



Note: Based on an individual paying in 1,000 units of a currency a year for a period of 45 years, achieving annual gross returns of 5% each year. Inflation and taxation impacts have been ignored; only the charges listed above apply. Owing to the wide range of cost estimates and the unknown cost of providing minimum guarantees, it was not possible to include Germany or Austria.  
Source: Oxera analysis.

*(d) Locked-in nature of some PPPs*

For certain PPPs, which are by nature very long-term products, the insufficient flexibility for savers to switch between products and providers is a major disincentive to take-up. Currently, the majority of existing products do not allow for switching provider, or else switching is costly and subject to penalising exit fees (*See an analysis of the costs of switching and advice in Annex 9*). The Irish Competition and Consumer Protection Commission indicated that for unit-linked funds in Ireland, the costs of early withdrawals (which may be triggered by the wish to switch providers) typically amount to 1% up to 5% of assets under management<sup>35</sup>. Complexity often arises with regard to insurance-based products, whereby individual schemes may impose additional restrictions on switching, such as termination fees<sup>36</sup>. The risk of being locked in a product or with a provider for a long time, especially until retirement age, regardless of the performance of the product, is a reason for consumers to be cautious with regard to acquiring some PPPs<sup>37</sup>. A thematic review of the treatment of long-standing customers in a similarly long-term business like the life insurance sector by the UK Financial

<sup>35</sup> Irish Competition and Consumer Protection Commission, available at <http://www.consumerhelp.ie/investment-fees-charges>

<sup>36</sup> Oxera: Study on the position of savers in private pension products, 2013

<sup>37</sup> EIOPA technical advice, page 58.

Conduct Authority found that the impact these charges can have on returns can be significant and may present barriers to shopping around<sup>38</sup>.

*(e) Decumulation options*

The decumulation or payout phase of a PPP is the period during which assets (accrued in the accumulation phase) are paid out to the saver. Decumulation options of PPPs, i.e. the way that benefits are paid at retirement, display significant variations across Member States. Based on the EIOPA database of pensions plans and products in the EEA<sup>39</sup>, the possible forms of retirement payments are annuities (a stream of payments for as long as the retiree lives), lump sums (a single payment), and programmed withdrawals (a series of fixed or variable payments whereby the annuitant draws down a part of the accumulated capital).

The EIOPA advice<sup>40</sup> and the EPPF Study show that currently available PPPs sometimes have restrictions as regard the choice of out-payments. Such restrictions are either imposed by providers or due to national legislation. The use of a certain form of out-payments might also be linked to tax incentives<sup>41</sup>. As shown in Figure 4 below, only the annuity-based form of retirement payment is possible for a majority of PPPs with 44% of PPPs covered by the EPPF Study only allowing for annuities. According to the EPPF Study (Interim Report), annuity is legally mandatory for nine PPP schemes in six Member States (Denmark, Finland, France, Germany, the Netherlands and Sweden)<sup>42</sup>. However, they do not lead to tax incentives, save from the Dutch PPPs. In Finland, the Netherlands and Sweden there are no PPP schemes allowing lump sums as a decumulation option. According to the EPPF Study, twenty-five Member States<sup>43</sup> in principle allow lump sums as a decumulation option (but sometimes only if combined with annuities<sup>44</sup>).

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<sup>38</sup> FCA Statement on fair treatment of long-standing customers in the life insurance sector, March 2016 available at: <https://www.fca.org.uk/news/statements/fca-statement-fair-treatment-long-standing-customers-life-insurance-sector>

<sup>39</sup> <https://eiopa.europa.eu/regulation-supervision/pensions/database-of-pension-plans-and-products-in-the-eea>

<sup>40</sup> EIOPA: Towards an EU single market for personal pensions: An EIOPA Preliminary Report to COM, 2014.

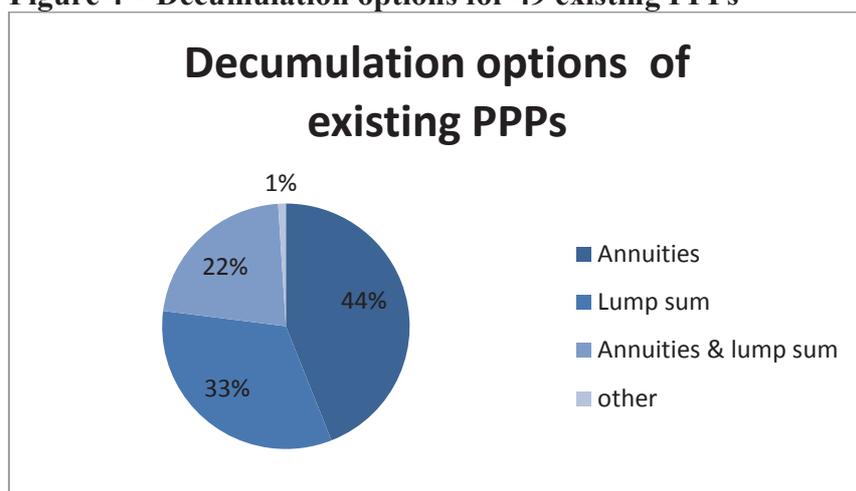
<sup>41</sup> A clear distinction should be made between two aspects of the decumulation: 1) mandatory form of decumulation required by the legislation applicable to a PPP scheme in a Member State; 2) form of decumulation which may not be mandatory (i.e. the only legally possible way of decumulation), but which is an explicit pre-requisite for some tax benefit in the decumulation phase.

<sup>42</sup> More specifically, out of three PPP schemes in Denmark, one ("*Ratepension*") treats annuities as mandatory option; in France two PPP schemes ("*Madelin*" & "*Madelin agricole*") out of three require annuities as mandatory option; in Germany one ("*Riester-Rente*") out of the three PPP schemes requires annuities as mandatory option.

<sup>43</sup> Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark (not all PPPs there), Estonia, France (not all PPPs there), Germany (not all PPPs there), Greece, Hungary, Ireland (one of the available PPP schemes requires a combination of lump sum and annuities), Italy (combination of lump sum and annuities), Latvia, Lithuania, Luxembourg (combination of lump sum and annuities), Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and the United Kingdom.

<sup>44</sup> In Ireland, Italy and Luxembourg.

**Figure 4 – Decumulation options for 49 existing PPPs**



*Source: EPPF Study, Interim Report, p. 39*

Contributions made by consumer associations to the public consultation also touch upon this problem suggesting that savers desire flexibility as regards decumulation options at the age of retirement. Indeed, major consumer associations responding considered that decumulation options should be flexible and should be based on the choice of the individual.

*(f) Protection of the savings invested in the PPPs*

As personal pension products have a long-term nature, some savers are concerned with the eventual product of their savings on retirement. Contributions for retirement provisions constitute often one of the most important investments during a person's life-time. That is why some consumer associations underlined the need for enhanced protection of savings in PPPs. On the other hand, consumer associations also indicate that adequate protection should not hamper investment strategies aiming at better returns.

The EIOPA technical advice shows that only 20 % of PPPs currently on the market provide some type of a guarantee. The vast majority of PPPs are pure defined contribution (DC) products, representing a market share of 80 percent. Defined benefit (DB) pension schemes represent only a very small portion of the total PPPs.

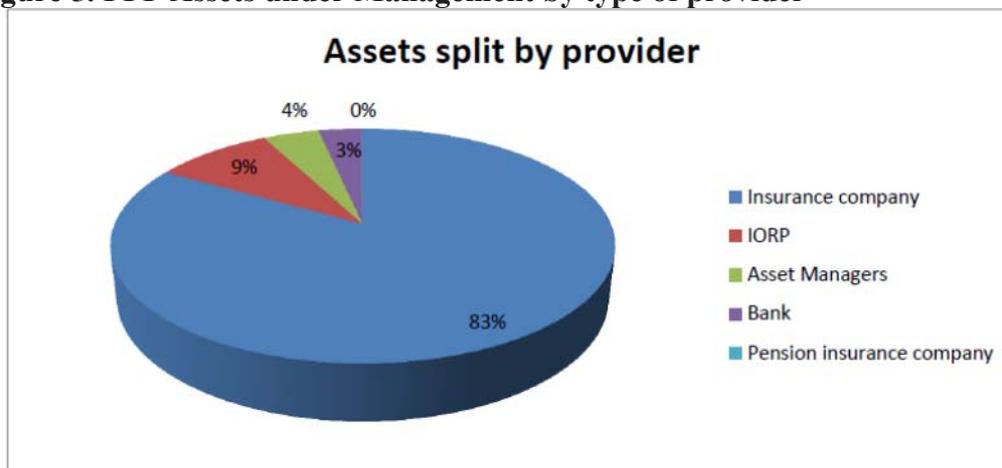
On the other hand, consumer associations also indicated that guarantees are often a costly product feature adding to the complexity of PPPs. Furthermore, some consumer organisations consider that guarantees are sometimes misleading, especially if only the nominal capital is guaranteed, without taking into account inflation; in their view, a guarantee on capital is only useful if the real value of the capital saved (taking into account inflation) is protected. Some other consumer organisations considered that a guarantee might be beneficial for consumers close to retirement, if at least they compensate for inflation. During the public consultation, providers such as asset managers and investment funds indicated that other risk mitigation techniques, such as life-cycling<sup>45</sup> could have a similar effect to providing a guarantee on capital.

<sup>45</sup> Life-cycling involves changing the composition and risk profile of the investment portfolio over time, with a more aggressive profile at the start, progressively becoming more conservative as the saver nears retirement.

### 2.2.2. *Insufficiently diverse supply of PPPs*

At present, the supply of PPPs is mostly dominated by insurers and limited to a set of national providers<sup>46</sup>. The EIOPA technical advice demonstrates that PPPs are currently overwhelmingly sold by insurers (more than 80% of assets under management of PPPs, as shown in Figure 5 below). Occupational pension funds and asset managers represent respectively only 9% and 4% of assets under management. The limited number of providers supplying PPPs reduces choice for savers, as more providers could provide products with a bigger range of product features. For example, insurers typically provide guarantees for in-payments and annuities for out-payments. Alternative providers could favour distinct risk mitigating strategies for in-payments and distinct options for out-payments. EIOPA considers that as a consequence, savers cannot reap the benefits of wider choice of provider, better quality and lower prices due to the insufficient EU-wide competition between market players. Figure 5 bis below shows the limited take-up of personal pensions in certain Member States.

**Figure 5. PPP Assets under Management by type of provider**

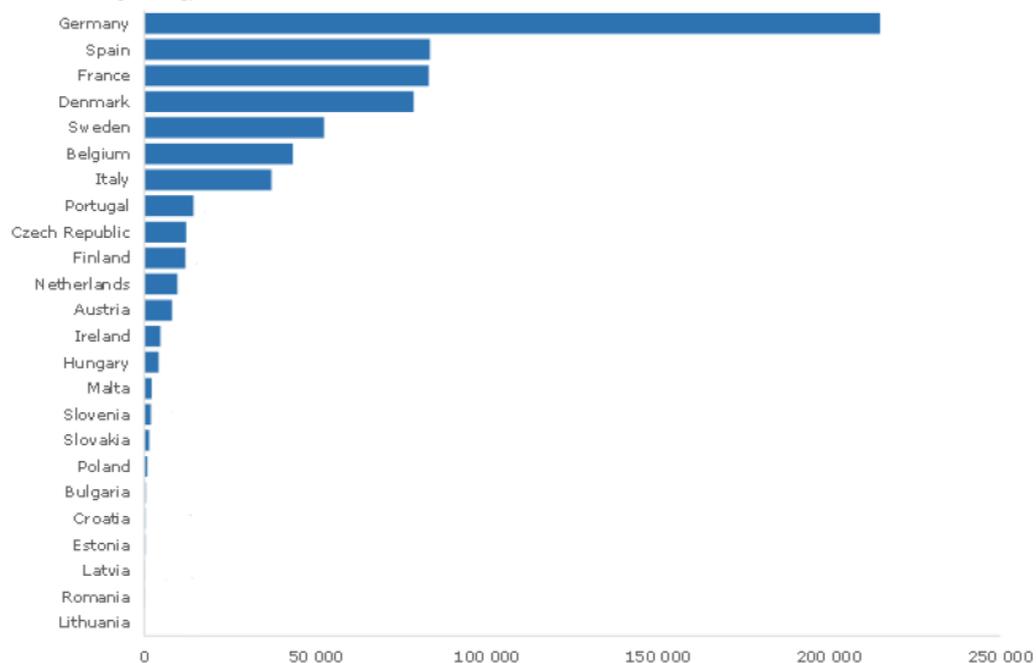


Source: EIOPA technical advice

<sup>46</sup> EPPF Study, Interim Report.

**Figure 5 bis- Assets under Management in Personal Pensions by Member State**

In € Million [24 MS], 2014



Source

e: EPPF Study

In addition, the public consultation indicates limited satisfaction of savers with the supply of PPPs. On the other hand, it is instructive that most of the professional stakeholders responding to the public consultation do not actually supply PPPs, and almost half of those which do so are active in only one Member State. The low supply of personal pension products seems to be significantly due to certain national regulatory requirements that are in place for justified reasons (e.g. prudential requirements and consumer protection), but may however have the effect of limiting competition and market access<sup>47</sup>. In addition, stakeholders repeatedly pointed in their contributions to the public consultation to the hurdles represented by tax requirements, which are presented later in this impact assessment.

### 2.3. Incomplete internal market for personal pension products

Two main obstacles result in an incomplete internal market for personal pension products: an insufficient degree of portability across borders and diverging legal requirements.

#### 2.3.1. *Insufficient degree of cross-border provision and portability*

Existing personal pension products are not adapted to the needs of mobile workers, which may vary during the lifetime of a PPP, notably when exercising mobility in the EU. Even when portability of PPPs is not legally or contractually prohibited, cross-border portability is de facto difficult in practice, harming intra-EU mobile workers. In particular, the recognition and transfer of pension contributions across providers and across Member States is hindered<sup>48</sup>. As a consequence, mobile workers, in practice, need to sign up for a new personal pension

<sup>47</sup> See EIOPA 2014 advice – Towards an EU single Market for Personal Pensions, section 4, p. 28-37.

<sup>48</sup> See ECJ C-269/07, Judgment of 10.09.2009, *Commission v Germany*, where the Court expressly states that tax reimbursement obligations impeding the portability of private pension products discriminate against migrant workers infringing therefore Article 45 TFEU.

product when moving across borders. On retirement, mobile workers could end up with multiple pension products from distinct providers, subject to distinct national requirements. Therefore, mobile workers are incentivised to save for retirement through other means, limiting the take-up of personal pension products. The insufficient provision of suitable products for mobile workers may thus negatively affect labour mobility in the EU.

According to a 2010 Eurobarometer survey<sup>49</sup>, 10% of people polled in the EU replied that they had lived and worked in another Member State at some point in the past, while 17% intended to take advantage of the right to free movement in the future. The recent trend of intra-EU mobility is positive (e.g. 2004: 1.7%, 2008: 2.4%, 2012: 2.8%) with the pace picking up again after the economic recession. Indeed, according to the 2016 Annual Report on intra-EU Labour Mobility<sup>50</sup>, almost 11.3 million EU citizens of working age (20-64 years) were residing in a Member State other than their country of citizenship, making up 3.7% of the total working-age population across the EU-28. In addition, there were in 2015, 1.4 million retired EU citizens living in a Member State other than their country of citizenship.

Moreover, according to a 2016 Eurobarometer survey<sup>51</sup>, 71% of the respondents agree that free movement of people within the EU brings overall benefits to the economy.

As an example of mobile workers, researchers often spend a part of their career in different EU Member States working on distinct projects, often with multiple employers. The MORE 2<sup>52</sup> study shows that, out of a population of 1.2 million researchers, on average 15% percent are currently mobile. 30% of researchers have been mobile during the last ten years. Due to insufficient portability they have difficulties to save for retirement by means of personal pension products. As a targeted response to such needs, the Resaver pension fund enables employees to remain with the same pension arrangement when moving between Member States and when changing jobs<sup>53</sup>.

According to the feedback from professional stakeholders taking part in the public consultation, there are a number of hurdles that prevent providers from supplying PPPs on a cross-border basis. These include an unfamiliar customer base combined with language and cultural differences, distinct expectations of the local policyholders, the risks and prevalence of fraud; the supervisory environment and national prudential rules, the current generosity of public pension systems in some Member States, local dominant distribution channels and branding difficulties. The differences in national tax treatment are the most important. These barriers are presented in more detail below.

As part of its technical advice, EIOPA conducted a quantitative study<sup>54</sup> to identify cross-border requirements for third pillar products. EIOPA collected data from thirteen Member States (Belgium, Bulgaria, Czech Republic, Estonia, France, Croatia, Italy, Lithuania, Luxemburg, Hungary, Malta, Portugal, Slovakia) with regards to cross-border contracts. Other Member States could not provide detailed information with respect to cross-border services of PPPs.

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<sup>49</sup> [http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU\\_3.1.3.html](http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_3.1.3.html)

<sup>50</sup> European Commission - 2016 Annual Report on intra-EU labour mobility, December 2016 (ISSN: 2529-3281).

<sup>51</sup> [http://ec.europa.eu/justice/citizen/document/files/2016-flash-eurobarometer-430-citizenship\\_en.pdf](http://ec.europa.eu/justice/citizen/document/files/2016-flash-eurobarometer-430-citizenship_en.pdf)

<sup>52</sup> MORE2 Higher Education Institutions (HEI) report, June 2013.

<sup>53</sup> <http://www.resaver.eu/>; See also Section 3.2. below.

<sup>54</sup> EIOPA technical advice, page 94.

This study shows that only 4% of the assets under management of these thirteen Member States result from cross-border business. However, there are large differences between Member States. In the vast majority of Member States (Belgium, Czech Republic, Estonia, France, Croatia, Luxemburg, Hungary, Slovakia) cross-border business represents less than 2% of assets under management. According to the same study, in Italy, Portugal and Lithuania cross-border business represents respectively 10%, 20% and 30% of all assets under management. In two Member States, Bulgaria and Malta, more than 75% of the assets under management result from products provided by cross-border entities. In Bulgaria, PPPs are provided by companies from other Member States or from outside the EU establishing a branch, whereas in Malta all PPPs are contracted with providers from other Member States or from outside the EU.

### 2.3.2. *Diverging legal requirements*

Today, due to diverging legal requirements at national level, there is no genuine single market for existing personal pension products – and design, distribution, contract law, as well as consumer protections are widely different. And for instance, EU legislation on distribution requirements for investment products such as IDD<sup>55</sup>, MiFID II<sup>56</sup> and the PRIIPs Regulation<sup>57</sup> do not apply to most personal pension products<sup>58</sup>. Indeed, products which under national law are "*recognised as having the primary purpose of providing the investor with an income in retirement, and which entitle the investor to certain benefits*" are exempted.

Other national legal requirements are also diverse. Table 3 below shows the diversity of tax regimes applied in various Member States, based on 49 existing personal pension products across the EU. In some cases, the tax regimes vary for existing personal pension products within the same Member State (e.g. Poland).

Most Member States apply either the so-called EET system (**E**xempt contributions, **E**xempt investment income and capital gains of the pension institution, **T**axed benefits) or the ETT principle (**E**xempt contributions, **T**axed investment income and capital gains of the pension institution, **T**axed benefits). Other systems (such as TET, TEE, EEE) are less common, but can also be found across the EU. Even within the EET system, the requirements for tax deductibility of contributions vary widely from one Member State to another and may be often limited to a certain level of income replacement or a fixed amount. Therefore, in order to offer qualifying PPPs in different Member States, PPP suppliers manufacture and distribute (through subsidiaries or branches where appropriate) products which are tailored to the tax law of each Member State and thus do not achieve economies of scale, due to a lack of standardisation.

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<sup>55</sup> Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast).

<sup>56</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast).

<sup>57</sup> Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

<sup>58</sup> See below, point 4.3.1.1.

**Table 3: overview of direct income tax regimes applicable to personal pension products**

Tax regimes	Accumulation		Decumulation at the moment of the retirement	Number of PPPs in our study	
	In-payments	Yield			
Tax regime 1 – Incentives applied on in-payments and decumulation phases	E	E	E	9	42
	E	T	E	2	
Tax regime 2 – Incentives focused on in-payments	E	E	T	25	
	E	T	T	6	
Tax regime 3 – Incentives focused on the decumulation phase	T	T	E	2	7
	T	E	E	2	
Tax regime 4 – No incentive neither on in-payments nor decumulation	T	T	T	1	
	T	E	T	2	

Source: EPPF Study Interim Report

Within the 49 products identified in the Study there are no two products with 100% identical requirements from a tax perspective, in some cases even within a Member State. As a consequence, a product cannot qualify for tax incentives in more than one Member State.

The diverging legal requirements across Member States result in the following effects, leading to the absence of a single market for personal pensions:

**- Difficulty for providers to operate across borders as they need to adapt their PPPs to cater for national requirements.** Based on the 49 PPPs surveyed in the EPPF Study, product legislation varies significantly across Member States, for instance on authorising savers to switch providers. The product legislation does not necessarily have a tax dimension. More specifically, failing compliance with every single tax requirement a PPP cannot qualify for tax relief. The differences between national tax requirements indeed require designing distinct products to access national markets. As an example, in order to benefit from tax relief, PPPs in three Member States (Austria, the Netherlands, Slovenia) must have annuities for out-payments in the decumulation phase, those in two Member States (Cyprus, Malta) require a lump sum, while thirteen Member States allow for both annuities and lump sums to benefit from tax incentives. In other Member States the out-payments are taxed, whatever the decumulation option (annuities, lump sum or a combination of both)<sup>59</sup>. An operator willing to operate across borders in those jurisdictions would be required to offer a product with lump sum in certain Member States and a product with annuities in other Member States. Such requirements result in the need to design a national product and hinder providers from

<sup>59</sup> EPPF Study, Interim Report.

entering a market of another Member State, even where the potential for PPPs is not fully tapped. As already mentioned, EIOPA estimated in 2015 that only 4% of personal pension asset volumes are sold across borders in the EEA<sup>60</sup>.

- The transfer of accumulated capital from a TEE/TTE Member State to an EET/ETT Member State can **lead to double taxation**. The double taxation is, for example, the result of the denial of tax relief for contributions made in Member State A and the taxation of the pension in Member State B. On the other hand, a transfer from an EET/ETT system to a TEE/TTE system may lead to non-taxation. Furthermore, it cannot be ruled out that the tax administration of a Member State would retrospectively deny tax credit granted in case of the transfer of accumulated savings outside its jurisdiction to a Member State that prescribes different condition for tax relief (e.g. enables to take programmed withdrawal, or sets out different minimum retirement age). Since direct taxation is within the competence of individual Member States, the variety in taxation regimes hinders the application of the principle of non-discrimination under EU law<sup>61</sup>.

In some Member States, specific legal requirements result in a limited supply of certain products. For example, the option to exit with a lump sum is not available in six Member States, as this would be dis-incentivised in a prohibitive way by national tax requirements<sup>62</sup>. In other cases, legal or tax restrictions on investment options can have adverse consequences on returns. For example, some national rules limit tax benefits to products that offer a guarantee on return. In the current economic context of low interest rates this requirement could result in high costs for providers and correspondently low returns for savers, making the product un-attractive.

#### **2.4. Other factors out of scope of this impact assessment**

Besides the main drivers, problems, and consequences that are assessed above, the problem tree (*see below*) also shows a number of other factors that are outside of the assessment scope. These other factors are described below.

Demographic changes in the following years will lead to the ageing of the population and an increased number of pensioners. Such demographic tendencies increase the costs of existing pension systems and put pressure on public finances, creating incentives for measures by public authorities.

Such measures in public and occupational pension schemes can affect pension adequacy and hence affect the need for additional personal savings for retirement. The pressure on state-run pensions systems is well documented, and was described in the 2012 White Paper on adequate, safe and sustainable pensions<sup>63</sup>. While state-based pensions provide the majority of retirement income in the EU, demographic and fiscal pressures would limit their capacity to sustain adequate retirement incomes in the long run<sup>64</sup>. Accordingly, supplementary retirement sources

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<sup>60</sup> EIOPA technical advice, p. 8.

<sup>61</sup> See EIOPA: Towards an EU single market for personal pensions: An EIOPA Preliminary Report to COM, 2014.

<sup>62</sup> For example, the Dutch tax law penalises the pay-out of a lump sum by a high tax rate. Source: EIOPA technical advice, p. 60.

<sup>63</sup> COM(2012) 55 final, of 16 February 2012.

<sup>64</sup> Carone, Giuseppe and Costello, Declan and Diez Guardia, Nuria and Eckefeldt, Per and Mourre, Gilles, Economic Growth and Fiscal Sustainability in the EU: The Impact of an Ageing Population (April 3, 2008). Available at SSRN: <https://ssrn.com/abstract=1997174> or <http://dx.doi.org/10.2139/ssrn.1997174>

such as personal pensions are likely to increase and can bring a positive contribution to solving the pension challenge<sup>65</sup>. The Annual Growth Survey (AGS) 2017<sup>66</sup> noted that "broad coverage of supplementary (occupational and personal) pensions can play a key role in retirement income provision, in particular where the adequacy of public pensions might be a challenge, and should be promoted by appropriate means, depending on the national context".

A well-functioning internal market for personal pension that provides better options for citizens to save for retirement could, as a potential long term side impact, contribute to addressing the existing pension gap (*See Glossary in Annex 5*) as well as deteriorating replacement ratios. The main side effect achieved over time could be that retirees across Europe have better options to save for retirement to help address potential shortages in retirement income.

At the same time, the coverage of supplementary pensions, and thus their contribution to pension adequacy, remains very uneven across the EU. Personal pensions have relatively wide take-up in only a few Member States (over 60% coverage in the Czech Republic, over 30% in Sweden and Germany<sup>67</sup>) while in most Member States take-up is moderate and fragmented, and in some, nearly non-existent.

In addition, the ongoing dynamics of the labour market result in a more mobile workforce and an increase of self-employed workers with often inadequate pension savings. Another factor leading to low demand for personal pensions is the limited disposable income available for saving for retirement in some Member States, especially amongst young generations.

These issues are not covered by this impact assessment.

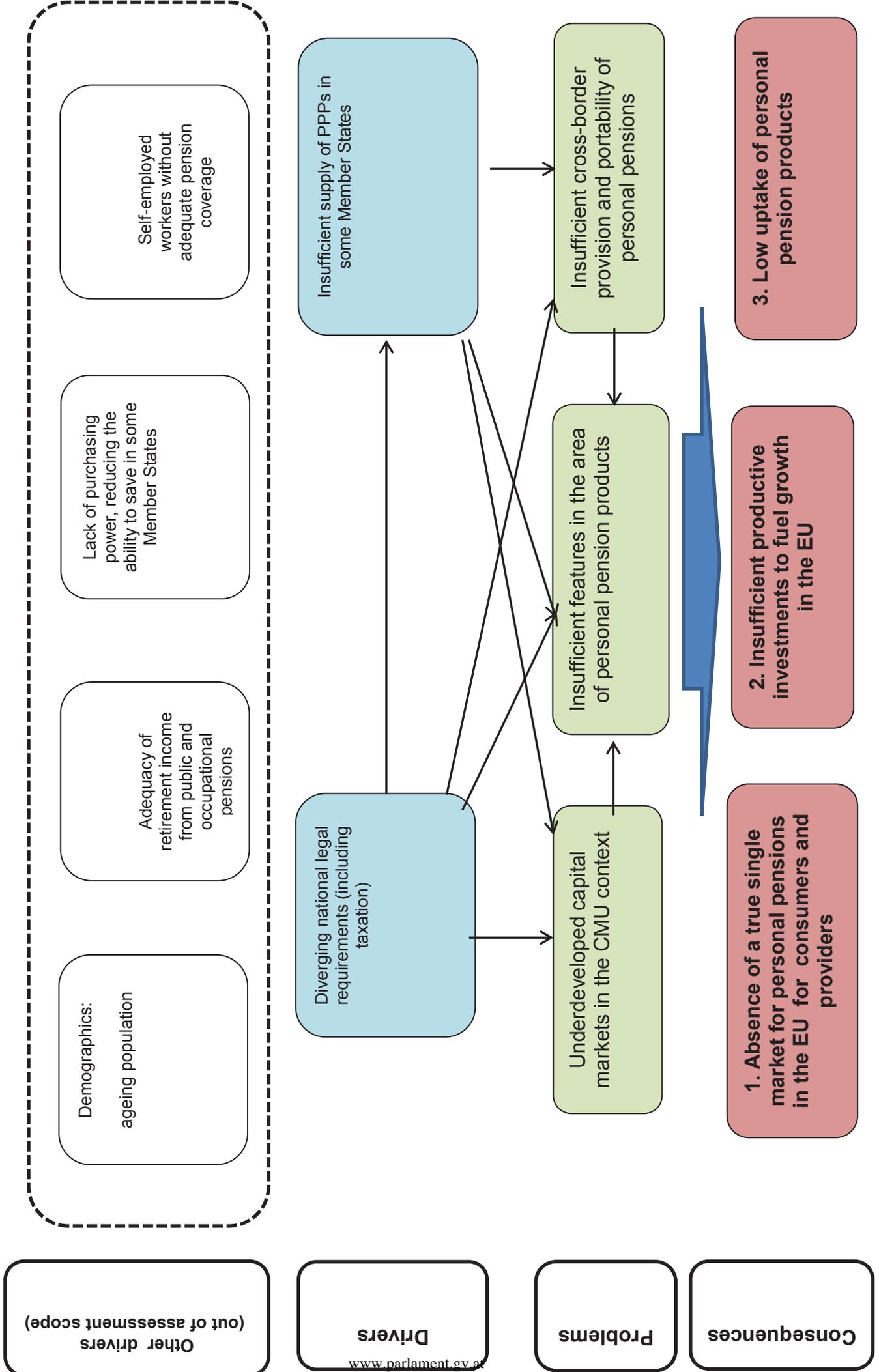
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<sup>65</sup> OECD, Pensions at a Glance 2011, Retirement-income Systems in OECD and G20 Countries, p. 176-177, available at: [http://www.oecd-ilibrary.org/finance-and-investment/pensions-at-a-glance-2011\\_pension\\_glance-2011-en;jsessionid=5f2dmm3ii527f.x-oecd-live-03ISBN:9789264096288\(PDF\);9789264095236\(print\)](http://www.oecd-ilibrary.org/finance-and-investment/pensions-at-a-glance-2011_pension_glance-2011-en;jsessionid=5f2dmm3ii527f.x-oecd-live-03ISBN:9789264096288(PDF);9789264095236(print))

<sup>66</sup> Annual Growth Survey 2017 (COM(2016)725 final of 16 November 2016), p. 12, available at: [https://ec.europa.eu/info/sites/info/files/2017-european-semester-annual-growth-survey\\_en\\_0.pdf](https://ec.europa.eu/info/sites/info/files/2017-european-semester-annual-growth-survey_en_0.pdf)

<sup>67</sup> Idem.

# Problem Tree



### 3. OBJECTIVES

#### 3.1. General and specific objectives

For the EU economy in general, an EU personal pension framework could contribute to address some of the personal pension market shortcomings and to increasing savings and investment. The PEPP framework could indeed help to create large pools of pension savings, thus injecting more savings into capital markets and channel additional financing to productive long-term investments which would contribute among other projects to complete the CMU.

Regarding the product features on the personal pension market, the PEPP framework could bring more simplicity, safety, transparency, cross-border enhancements and overall minimum quality standards to the personal pension market, addressing the needs of savers and providers. This could improve the attractiveness of personal pension products, towards creating in the long run a single market for personal pensions.

These general objectives can be broken down in the following, more **specific objectives**:

Problems	Specific objectives
Underdeveloped capital markets in the CMU context	Increase investment in the EU and contribute to completing the CMU
Insufficient features in the area of PPPs	Enhance product features on the personal pension market
Cross-border problems: insufficient cross-border provision of personal pensions and their portability	Enhance the cross-border provision and portability of personal pension products

#### 3.2. Consistency of the objectives with other EU policies

The initiative would reduce the obstacles to cross-border provision of personal pension products, overcoming existing hurdles in national tax and legal requirements applicable to such products.

The initiative, by enhancing the cross-border portability of personal pension products, would contribute to further facilitating the free movement of workers, one of the key pillars of the internal market. Thus the initiative is in line with the objective of promoting labour mobility, highlighted in President Juncker's Political Guidelines for the European Commission<sup>68</sup>.

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<sup>68</sup> See Jean-Claude Juncker, A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change (Political Guidelines for the next European Commission, Strasbourg, 15 July 2014).

Developing a PEPP framework is also in line with the Commission's 2012 White Paper on Pensions<sup>69</sup>, and in particular with the intention of developing complementary private retirement schemes by encouraging Member States to optimise tax and other incentives for such schemes. The White Paper focusses on enhancing the safety of supplementary pension schemes<sup>70</sup>, as well as on making supplementary pensions compatible with mobility; it supports legislation protecting the pension rights of mobile workers<sup>71</sup> and promotes the establishment of pension tracking services across the EU. In accordance with another commitment in the White Paper<sup>72</sup>, the Commission is supporting, through Horizon 2020, a consortium of employers in creating a single European pension arrangement (RESAVER) that will offer a defined contribution plan, tailor-made for research organisations and their employees<sup>73</sup>.

### 3.3. Consistency of the objectives with fundamental rights

The EU is committed to high standards of protection of fundamental rights and is signatory to a broad set of conventions on human rights. In this context, the proposed objectives as discussed above are not likely to have a direct impact on these rights, as listed in the main United Nations conventions on human rights, the Charter of Fundamental Rights of the European Union which is an integral part of the EU Treaties, and the European Convention on Human Rights ('ECHR').

### 3.4. Subsidiarity

Regarding subsidiarity, under Article 4 TFEU, EU action for completing the internal market has to be appraised in the light of the subsidiarity principle set out in Article 5(3) TEU. Hence it must be assessed whether the objectives of the proposal could not be achieved by the Member States in the framework of their national legal systems and, by reason of its scale and effects, is better achieved at EU level.

#### 3.4.1. *The objectives of the proposed action cannot be sufficiently achieved by the Member States*

The uncoordinated efforts of Member States, either at central level or at regional and local level, cannot remedy the legal fragmentation in product regulation, which results in extra compliance cost for providers and discourages them from going cross-border. For instance, EU legislation on distribution requirements for financial products such as IDD<sup>74</sup>, MiFID II<sup>75</sup> and the PRIIPs Regulation<sup>76</sup> do not apply to most personal pension products, leaving national legislation to apply<sup>77</sup>.

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<sup>69</sup> White Paper "An Agenda for Adequate, Safe and Sustainable pensions", COM (2012) 55 final of 16 February 2012, available at:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0055:FIN:EN:PDF>

<sup>70</sup> Already done through the recast of the Directive on Institutions for Occupational Retirement Provision (Directive (EU) 2016/2341, OJ L 354 of 23 December 2016, p. 37).

<sup>71</sup> Partially achieved through the adoption of a directive on improving the acquisition and preservation of supplementary pension rights – Directive 2014/50/EU (OJ L 128 of 30 April 2014, p. 1).

<sup>72</sup> Pursuing the on-going work on a pan-European pension fund for researchers.

<sup>73</sup> See <http://www.resaver.eu/resaver/pension-fund/how-it-works/>

<sup>74</sup> Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast).

With PPP markets left exclusively to national regulation, asymmetric information issues can be observed between providers and savers, particularly in a cross-border context<sup>78</sup>. The insufficiently complete information to savers from providers at national level reduces trust in PPP providers and often results in fewer transactions, lower levels of engagement with pension provision, alongside poor decision-making by savers.

The portability of PPPs is a concern for individuals moving cross-border while trying to maintain the same product and provider. At present, upon changing residence to another Member State, individuals in practice have no choice but to search for a new product developed by a new provider in the new Member State, on the basis of substantially different rules, instead of continuing to save in their former Member State. National tax incentives encourage individuals to save for retirement and are key to promoting the take-up of personal pensions; losing such tax benefits on moving to another Member State is currently a barrier to the cross-border portability of personal pension products. Member States alone cannot remedy portability issues.

*3.4.2. The objectives of the proposed action, by reason of its scale and effects, can be better achieved at EU level*

Action at EU level can substantially add value to remedy the consequences, particularly in terms of costs, of market fragmentation. If no EU action is taken, asset pools are likely to remain small and limited to national borders, without economies of scale, and competition would remain restricted to domestic providers. Individual savers are therefore not likely to benefit from lower prices and better products that would result from efficiency gains and returns of large asset pools. Fragmentation is expensive also for providers: the smallest divergence in national regulation means extra compliance cost. There are limited incentives for providers to offer products cross-border mainly due to high costs. On the other hand, a standardised EU personal pension product is expected to cut providers' costs by creating larger asset pools. For example, a study<sup>79</sup> shows that spreading fixed costs over larger pool of members could save 25% administration costs.

The creation of an EU legislative framework for personal pensions would diminish providers' costs by creating economies of scale, particularly in the areas of investment and administration. The creation of an EU personal pensions statute would help providers operate cross-border as it would allow them to centralise certain functions at an EU-level<sup>80</sup> (rather than running them locally or outsourcing). Standardisation would make it

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<sup>75</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast).

<sup>76</sup> Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

<sup>77</sup> IDD however applies to pension products structured as life insurance.

<sup>78</sup> See EIOPA technical advice, section 2.2.2.: Bridging the information asymmetry, p. 27.

<sup>79</sup> Is there an optimal pension fund size? A scale economy analysis of administrative and investment costs, DNB Working paper No. 376. [https://www.dnb.nl/binaries/Working%20Paper%20376\\_tcm46-289626.pdf](https://www.dnb.nl/binaries/Working%20Paper%20376_tcm46-289626.pdf)

<sup>80</sup> According to a 2015 EFAMA consultation conducted amongst its members, 94% of respondents would pool and manage assets at a central level, 65% would centralise the administration and 47% would centralise the depositary function.

easier for providers to offer a pension solution to corporate clients active in several Member States and looking for an EU-wide personal pension solution for their employees. This could also bring a potential to realise efficiency gains in the area of distribution through using for example digital channels for selling personal pensions, as it is the case already e.g. in the UK. As such, EU legislative framework for personal pensions could be flanked by EU policy work in the area of FinTech<sup>81</sup>.

Greater choice of safe and high quality personal pension products is a benefit to all individuals, whether employed, mobile or self-employed. An EU single market for personal pensions would make the product accessible to a wider range of individuals. Minimum product requirements laid down in EU rules would create transparency and simplicity as well as safety for investors. In addition, it would accommodate the increasing mobility of EU citizens and the increasingly flexible nature of work (*see Annex 3 for more details on how stakeholders would be affected by this initiative*). For self-employed, who do not contribute in such capacity to a state-based or occupational pension, personal pensions could be an attractive way to save for retirement.

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<sup>81</sup> See [https://ec.europa.eu/info/finance-consultations-2017-fintech\\_en](https://ec.europa.eu/info/finance-consultations-2017-fintech_en) for more details.

## 4. POLICY OPTIONS AND ANALYSIS OF IMPACTS

The policy options and analysis of impacts are assessed in three consecutive steps.

In a first step, in section 4.1, the high level policy options under consideration are assessed against achieving the broad policy goals. In a second step, section 4.2 assesses the individual policy options of the preferred set of key product features and its implications in terms of tax treatment.

### 4.1. General policy options

As a first step, with a view to addressing the gaps described above, a range of high level policy options are described and analysed below. A "voluntary 2<sup>nd</sup> regime" designates a parallel EU-level regime, which would come in addition to the existing national personal pension regimes.

In the public consultation, several policy options were presented, including the creation of a personal pension product and the harmonisation of national regimes. Based on the replies received, they will be analysed further below.

Other policy options were also initially contemplated, such as the creation of a code of conduct<sup>82</sup> or of a personal pension account<sup>83</sup>. They are nevertheless not further analysed in the remainder of this section as they would not sufficiently address the objectives of completing the CMU and of enhancing product features of the personal pensions, not leading to the creation of a single market for personal pensions. Indeed, a code of conduct would lack legal certainty that there will be a single market for personal pensions. This option would therefore most likely not open up national markets to new types of providers.

As to a potential personal pension account, this option implies the existence of a "federal" tax on personal pension products, as in the USA, which is not considered in this Impact Assessment. In addition, as this regime is very flexible on the key features, a pension account could not bring the standardisation of personal pensions. In particular, this flexibility could lead to increased miss-selling risks, especially regarding savers with

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<sup>82</sup> Under this option, the EU would foster cooperation between stakeholders (Member States, providers, savers) around a common approach to the provision of personal pension products. This would imply designing, together with national authorities (in particular tax authorities), potential providers (insurers, pension funds, investment firms and asset managers and banks) and savers, a series of best practices which providers could follow when offering personal pensions. These best practices could be implemented through a code of conduct that could be adopted by national authorities (in particular taxation authorities) and providers.

<sup>83</sup> Under this option, a European personal pension account would be established, similarly to the Individual Retirement Arrangement (IRA) supplied in the United States. An IRA is a personal savings plan, which consolidates in one single account all investments in pension savings. Member States would be free to provide individuals tax advantages for savings in the pension account subject to conditions, for example the age of retirement. The pension account encompasses different types of plans, depending on the income or employment status of an individual, their tax circumstances and the investment options they choose. The personal pension account would be flexible and not pre-define investment options. Therefore, it would allow for investments in individual stocks and bonds, money market funds and mutual funds, life insurance products etc. There could be different types of providers including banks, credit unions, insurance companies, mutual fund companies and brokerage firms.

limited financial education. Overall, this option would limit the creation of a pension internal market, keeping this market local and not bringing any cross-border benefits.

High level policy option	Description
1. Baseline scenario	No policy action is taken
2. Pan-European Personal Pension Product (PEPP)	Establish a statute for a Pan-European personal pension product (PEPP), based on a set of common and flexible features through a voluntary 2 <sup>nd</sup> regime.
3. Harmonisation of national regimes	Harmonise national personal pension regimes on the key features of a personal pension product and disclosure requirements, taxation, type of providers and prudential supervision

#### 4.1.1. *Baseline scenario*

Under the baseline scenario, no action is undertaken and the problems described above would continue to exist. This would imply that the asset pools are likely to remain small, limited by national borders and providers would not benefit from economies of scale and investment diversification would be limited. As a consequence, there would be limited opportunities to transfer savings in personal pensions into long-term investments and providers and the development of a deep and liquid Capital Markets Union would be hindered.

Individuals would continue to have access to national pension products where they are currently available. However, they might not benefit from the best outcomes on retirement as national personal pension products would likely continue to provide insufficient transparency, remain costly and provide limited returns and might encounter difficulties to switch products. Importantly, in a number of Member States, there would be no personal pension product available. In addition, mobile workers would continue to have difficulties to manage savings in personal pension products when moving across borders and might not benefit from national tax incentives.

The contribution of PPPs to increase the savings for retirement would continue to follow the current trendline and gradually increase over time. This assumes that existing tax incentives on national products, where available, would continue to exist, driving uptake of existing PPPs. Based on a quantification exercise, under the baseline scenario the uptake of PPPs is estimated to increase (notably due to the continuation of inpayments in existing PPPs) from EUR 0.7 trillion today to EUR 1.4 trillion by 2030. Further explanation on the economic model can be found in *Annex 4*.

#### 4.1.2. *Pan-European personal pension product*

##### **Description**

Under this option, a legislative instrument (a Regulation) would define a pan-European personal pension product (PEPP) through a set of common rules, thereby establishing a 2<sup>nd</sup> regime in the European Union<sup>84</sup>. Similar types of 2<sup>nd</sup> regimes are in place, e.g. in the

<sup>84</sup> That is, an EU-level regime existing in parallel with national regimes.

area of company law<sup>85</sup> or financial services. Indeed, the regime for Undertakings for Collective Investment in Transferable Securities (UCITS) shows an example of a well-functioning EU single market for compliant investment funds. Similarly, a successful development of the PEPP over the coming years would set a benchmark for national personal products to follow in terms of product features.

### **Box 2 - The UCITS example**

Since its origin in 1985, the UCITS Directive, through its successive revisions, has been the basis on which a genuine European retail investment fund 'product' has been built. UCITS has created a comprehensive legal framework that offers increased investment opportunities for businesses and households alike.

At the same time, the directive also introduced a financial services 'passport', whereby a UCITS fund can be marketed across the EU, following authorisation from the competent authorities of its country of domicile (i.e. the home country) and notification to the competent authorities of the host market. Cross border subscriptions to UCITS compliant investment funds have grown considerably since the UCITS rules were first introduced in 1985. The UCITS acronym has developed into a strong EU brand and is nowadays, apart from Europe, also recognised in Asia and South America. The success of UCITS as a cross border vehicle for investments is borne out by the rapid growth of assets that are managed in UCITS compliant funds especially in the last years. As a matter of fact, after a slow start throughout the second half of the eighties, the total assets under management grew from just above EUR1 trillion in 1993 to EUR8.2 trillion by end 2015.

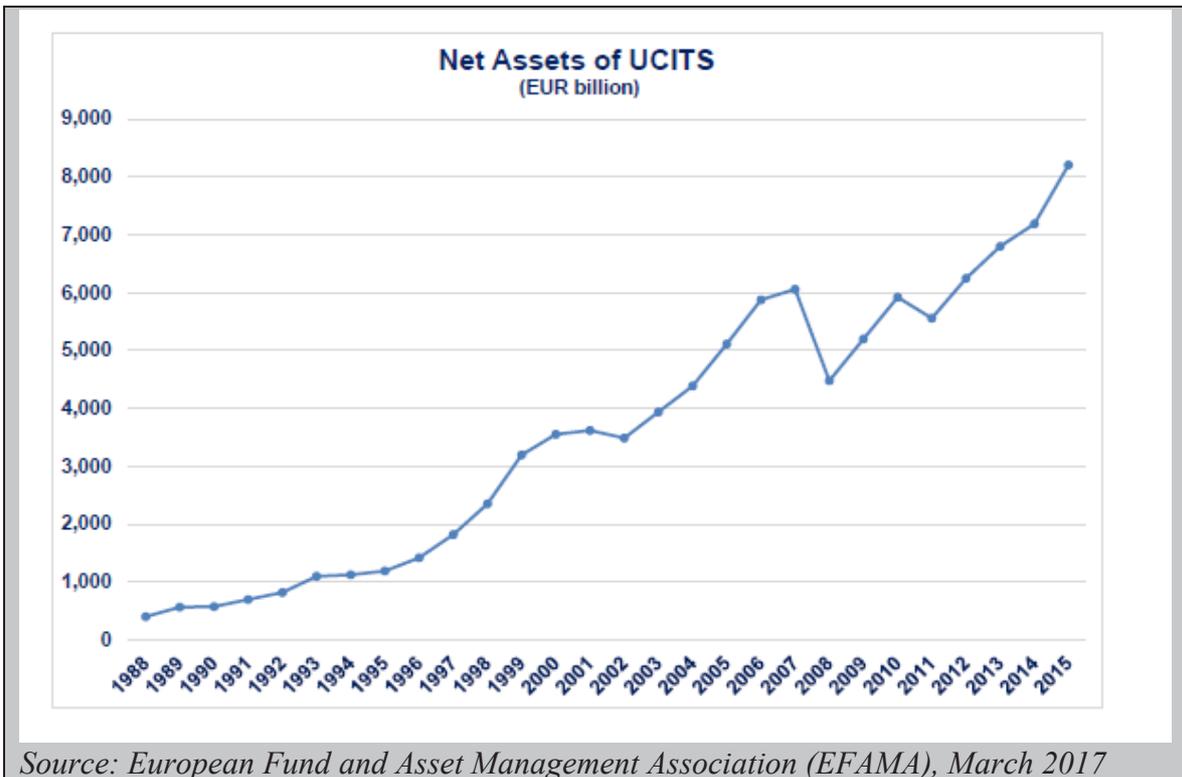
This success is essentially based on a robust harmonized framework, regularly updated since its inception and a fund passport.

The fact that fund managers have been competing on their domestic markets with investment funds and asset managers from other Member States led to an increase in the overall quality of the product offering available and also helped to reduce costs and fees.

The chart below shows the progression of the UCITS volumes over time. It shows that Assets under Management reached 2 trillion EUR over ten years after the launch of the framework.

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<sup>85</sup> See, for example, the European Company Statute - <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:126016&from=EN>



A "European statute" for such a personal pension product would define key features contributing to a single market for providers, helping complete the CMU and aiming to provide simple, transparent and safe products for PEPP savers. Such features could notably include rules on distribution and advice, information requirements, investment policy (see section on key features below). In addition to rules protecting PEPP savers for the sale of the product and during the accumulation or decumulation phases, the possibility to switch PEPP provider and benefit from portability would be key to addressing PEPP savers' concerns, in particular when exercising mobility within the European Union.

The optimal definition of the PEPP key features is further described in the next section, describing the options per key feature. In this respect, the key features should achieve balance between more standardisation for the PEPP and sufficient flexibility so that providers can adapt to the different national requirements for tax incentives. In addition, the tax treatment of the PEPP can be subject to more convergence, as presented in the next section.

In analogy with the UCITs example, it can be reasonably expected that the introduction of the PEPP would be a long term process which could take more than a decade to reach its full potential. In particular the tax treatment by Member States of the PEPP will be an important factor for the provision and the take-up of the PEPP. In addition, the uptake of the PEPP could potentially consist of an important substitution effect whereby funds currently saved in deposits, other investment products or even existing PPPs would be redirected towards the PEPP. Consequently, only a limited part of the PEPP uptake would be incremental savings.

Based on the same quantification assumptions as for the baseline scenario, the volumes of PPPs combined with the PEPP could reach EUR 2.1 trillion by 2030 in the most favourable scenario whereby the PEPP would be granted a favourable tax treatment in all Member States. This implies that the introduction of the PEPP would contribute to 50%

of the growth on the whole personal pension market between now and 2030. This estimate is based on the favourable assumption that PEPP would receive the same tax treatment as existing PPPs in all Member States under the baseline scenario. Should the favourable treatment of the PEPP be limited to fewer Member States, or even absent, the development of the PEPP would be sufficiently lower. Should no favourable tax treatment be granted, savers would be disincentivised to contribute to a PEPP and this would result in an outcome close to the baseline scenario of EUR 1.4 trillion. Nevertheless, the fiscal treatment of the PEPP could gradually develop over time, and national products could take on board the features of the PEPP. A detailed description of the economic model can be found in *Annex 4*.

## **Consequences**

Retail investors will be provided with an additional option to save for retirement, with high quality product features, ensuring the PEPP is a safe, transparent and pan-European pension product which has the potential to provide better returns. The PEPP project is to be conceived in a long-term perspective as the provision and take-up of PEPPs would take time. The overall consequences, extent and timing of benefits of this option would depend on the approach taken as regards the level of definition of product features and the implications for the national tax treatment of PEPPs. In general, all types of providers would benefit from economies of scale as the PEPP would allow creating larger asset pools and through the standardised product features. The provision of a personal pension product cross-border would be facilitated. Individuals, especially in Member States with low product supply, would benefit from more choice. 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.

## **Assessment**

The level of standardisation, and hence the possibility for providers to pool assets and achieve economies of scale, would depend on the key features determined in a statute. This would contribute to opening market opportunities to providers whose access is complicated by existing national requirements. In particular the PEPP is expected to increase competition in a market largely dominated by insurers, creating opportunities for asset managers, investment funds, pension funds and banks to enter a new market. Increased competition would bring benefits to savers by optimising product features, lowering costs and potentially improve returns. It would also allow savers to benefit from the wider range of provider choosing the product from those providers that better cater for their needs in terms of product features, offer lower costs or potentially higher returns.

Most professional stakeholders assumed in their responses to the public consultation that this option would largely address the challenges faced by existing PPPs in the EU – increasing investment in the EU and contributing to complete the CMU; enhancing product features on the personal pension market, in particular improving efficiency, asset allocation and returns; contributing to innovation within the PPP market; finally, increasing cross-border provision of PPPs by EU-based providers and widening of their range. As benefits of providing a personal pension product on an EU scale, most professional stakeholders which are insurance companies, SMEs and/or involved in the

management of funds esteem as very important the lower operating costs and making the product attractive to mobile customers.

The PEPP would co-exist with national products tailored to specific national requirements and qualifying for national tax incentives. However, even if its take-up would be affected by its tax treatment in the Member States, the establishment of a single market, as well as the standardisation of key components of the product would allow providers to compete and offer a simple, transparent and safe product on a European-wide basis. In their contribution to the public consultation, professional stakeholders, in particular asset managers, showed interest in the possibilities of standardisation provided by the PEPP, even without national tax incentives. As the PEPP framework would establish an additional regime in parallel to existing national regimes, any lack of take-up of the PEPP would not have a negative impact on the existing national regimes or products.

#### 4.1.3. *Harmonisation of national regimes*

##### **Description**

Under this option the EU would harmonise national personal pension regimes, either through partial harmonisation of the key features or through full harmonisation, including of the tax regime.

##### **Consequences**

Maximum harmonisation, including harmonisation of tax treatment, would contribute to establishing a real single market, as well as genuine pan-European products. A legislative statute would grant legal certainty to providers and protection to savers.

Harmonisation of the product features only would lead to a similar outcome as the establishment of a regulatory statute for a PEPP but involve major consequences for Member States' personal pensions markets.

##### **Assessment**

A maximum harmonisation option could bring the most in terms of creating a truly pan-European single market, with homogeneous asset pools and ease of cross-border access. Without it, national tax laws continue to incentivise most providers (i.e. the supply side) to offer different products and organise all related services (such as investment advice, taxation, accounting, distribution and transparency, reporting to supervisor) locally in each Member State. However, the feasibility of this option is questionable, in light of the differences between Member States' personal pensions regimes, both in terms of tax and labour law, and Member States' insufficient willingness to change their personal pension taxation rules.

The necessary changes to existing pension products would entail considerable compliance costs (unless they were "grandfathered" and could continue under previous rules).

Professional stakeholders expressed cautiousness on the option of harmonising national personal pension regimes, especially with a view to tax requirements. Most respondents, across all sectors and fields of activity, consider that such a solution would partly address

the challenges currently faced by the existing PPPs in EU, or would not address them at all.

### Comparison of policy options

<b>Objectives</b>	<b>EFFECTIVENESS</b>			<b>EFFICIENCY</b> <i>(cost-effectiveness)</i>	<b>COHERENCE</b>	<b>POLITICAL FEASIBILITY</b>
	<i>Objective 1</i>	<i>Objective 2</i>	<i>Objective 3</i>			
<b>Policy option</b>	<i>Increase investment in the EU and complete the CMU</i>	<i>Enhance product features on the personal pension market</i>	<i>Enhance the cross-border provision and portability of personal pension products</i>			
<b>Option 1</b> <i>No policy change</i>	0	0	0	0	0	0
<b>Option 2</b> <i>Personal Pension Product</i>	+	+	+	+	+	+
<b>Option 3</b> <i>Harmonisation of national legislation</i>	++	++	++	--	+	--

*Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable*

On objective 1 (increase investment and contribute to completing the CMU), the baseline scenario (option 1) would not result in a change as compared to the fragmentation of national capital markets today. Under the favourable assumption of preferential national tax treatment, the PEPP regime (option 2) would over time result in mobilising some part of household financial assets (e.g. deposits) towards capital markets and in asset pooling, whether providers offer a PEPP in one or several Member States.. While the effects on additional investments on capital markets would be limited, the PEPP framework would contribute to the CMU by further integrating national capital markets. Harmonisation of national regimes (option 3) would take the completion of the CMU further by directly harmonising the existing personal pension products.

On objective 2 (enhance product features on the personal pension market), the baseline scenario (option 1) would not address the suboptimal features identified above. The PEPP regime (option 2) would result in setting higher standards for existing personal pension products to replicate. Again, harmonisation of national regimes (option 3) would further address this objective by tackling all existing products.

Regarding objective 3 (cross-border), the baseline scenario (option 1) would not overcome barriers to cross-border provision and portability, they would not be coherent with other objectives such as improving workers mobility and improving access to retirement options for self-employed persons. On the contrary, options 2 and 3 could be expected to facilitate cross-border activity and portability and therefore also contribute to other policy objectives such as the workers mobility. However, while the harmonisation of national regimes (option 3) would bring the greatest theoretical benefits, it would imply upheaval on national pensions markets, including existing products.

On the objective of coherence with other EU policies, the baseline scenario (option 1) would obviously be neutral. The PEPP regime (option 2) would show some similarities to previous EU initiatives in financial services, such as the creation of a new product regime under the UCITS or ELTIF initiatives.

Regarding the objectives of efficiency and political feasibility, neither the public consultation nor the meeting with tax experts showed Member States' support to harmonisation (option 3). In particular, the harmonisation – if feasible - of existing regimes would most likely create considerable compliance costs for providers. Potential providers considered the harmonisation of national regimes as least effective (option 3). Similarly, harmonisation of national regimes (option 3) would be comparable to the creation of a single EU rulebook in the insurance or banking sectors. However support was expressed for a PEPP regime (option 2). Consumers contributing to the public consultation were highly supportive of the creation of a simple, transparent personal pension product. Potential providers demonstrated most support to the PEPP as regards its potential to address market shortcomings (enhanced take-up of personal pensions, increase competition, enhanced market access by providers, cross-border activity, innovation), even if national tax incentives would not be available..

Accordingly, the preferred option is option 2, i.e. a regulatory statute for a pan-European personal pension product creating a second regime. The standardisation of key product features would create opportunities for providers to build economies of scale and facilitate cross-border provision. Consumers would benefit from a set of harmonised product features, greater choice and adequate protection when saving for retirement. Such a statute would not require existing personal products to adapt to a new regulatory environment and indeed not affect existing regimes. As it would be favoured by both savers and providers, this option has the potential to result in market adoption in the long term. Nevertheless, the tax treatment would remain an important factor for market adoption of the PEPP.

#### **4.2. Key features of a regulatory statute establishing a PEPP**

This section first examines the key features of the five PPPs with the highest penetration index, which serve as a benchmark for assessing the appropriate features of a European personal pension product (PEPP).

These key features include 1) the distribution to PEPP savers, 2) rules applicable to investments, in particular the provider investment policy and the PEPP saver investment choice, 3) how to cater for switching between providers, 4) how to enable cross-border provision and portability; 5); how PEPP savers can draw funds from their PEPP on retirement (decumulation).

Elements pertaining to national social, tax and labour laws would be left to national rules and are thus not covered in this section. Indeed, the PEPP framework seeks to harmonise only a limited set of key features. Accordingly, conditions relating to the accumulation phase (e.g. minimum and maximum contribution required, possibility to change the level of contribution, maximum age limit for the start of the accumulation phase, possibility to take a break in the contributions, possibility for the employer to complement the contribution by the individual) or the decumulation phase (e.g. minimum age to trigger

the decumulation) remain regulated at national level, while the type of decumulation payments (annuities, lump sum), would still be part of the key features (see below).

### Key features of PPPs with the highest penetration index

According to the Better Finance Study on Pensions Savings – The Real Return<sup>86</sup>, most existing PPPs display a net return just above the inflation rate, whilst some even display negative net returns. Costs and charges are often considered as high and opaque. Retail investors, who receive insufficient information on the performance of the product, are often locked in long-term contracts with no possibility to switch provider, or where allowed, limited choice between alternative providers.

The EPPF study identified, among thirty-six personal pension products surveyed, five PPPs with highest penetration index<sup>87</sup>. These are the Riester Rente (Germany), the Pension Plan (Belgium), the Ratepension (Denmark), the Individual personal pension plan (Spain) and the State Sponsored Retirement Provision (Austria).

The PPPs with the highest volume of assets under management, the Riester Rente, are managing together EUR 224 billion.

Common features are observed within these PPPs:

- on **distribution rules**, advice is available to PEPP savers online;
- on **investment policy**, these PPPs include several investment options for PEPP savers and allow for changing investment options over the lifetime of the PPP<sup>88</sup>;
- on **cross-border portability and provision**, no information on nationality or physical address is required, i.e. cross-border provision is possible;
- on **provider switching**, domestic switching is possible without a tax impact. This is the case for instance for the Riester Rente in Germany, while another German PPP, the Rürup Rente, does not include this feature but has a lower penetration index. Three out of the five PPPs with the highest penetration index allow for switching providers on a cross-border basis, without a tax impact;
- on **decumulation options**, four of them provide for more than one decumulation option (annuity, lump sum, etc). Actually, among the twelve PPPs with the highest penetration index out, those providing more than one decumulation option have a higher penetration index.

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[http://betterfinance.eu/fileadmin/user\\_upload/documents/Research\\_Reports/en/Pension\\_report\\_2016\\_For\\_Web\\_-\\_Final.pdf](http://betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/Pension_report_2016_For_Web_-_Final.pdf)

<sup>87</sup> The criteria for high penetration include the percentage of assets under management in a PPP as compared to the household's financial assets, the percentage of PPP subscribers as compared to a Member State's population and the dynamics of accumulation into the PPP as compared to that of accumulation into savings products in a Member State.

<sup>88</sup> On a broader basis, half of the twelve PPPs with highest penetration index include a default investment option; a majority of them include a de-risking investment option close to retirement and a guaranteed minimum return on investment.

## Options for the key features of a PEPP

The comparative analysis of PPPs with highest penetration index serves as a point of reference for the determination of the key feature of the PEPP.

A synthesis of all policy options for the key and other features of the PEPP is presented in *Annex 7*. Finally, details on other features, such as costs and charges, the inclusion of a biometric guarantee, or the depositary function, are presented in *Annex 10*.

### 4.2.1. Distribution rules

In order to maximise supply on an EU-wide basis, a PEPP should be distributed by different types of operators (banks and insurers, insurance agents and brokers, investment firms, fund managers or pension funds) and through a variety of distribution channels. Depending on the features of the product and the type of seller, the distribution of PEPPs could be subject to different distribution regimes. This raises the question of the most appropriate way to determine the applicable distribution rules for PEPPs, in particular with regard to the requirements for advice and disclosure of information.

Three options may be considered:

Policy option	Description
1. Existing EU sectoral legislation applies, or if absent national legislation	Apply the existing EU sectoral rules pertinent to the distribution advice and information requirements and the legal characteristics of the PEPP
2. Full stand-alone distribution regime	Create a specific regime for PEPP in the form of a full stand-alone regime covering all channels and aspects of distribution, advice and information requirements
3. Combination of PEPP-specific add-on rules with application of sectoral rules	Create a limited set of PEPP-specific add-on rules that would be combined with the application of the existing sectoral rules

In addition to the advantage of simplicity, Option 1 would establish a level-playing field between PEPPs and national pension products sold by the same distributor. However, personal pension products are currently to a large extent excluded from the scope of harmonised EU distribution legislation<sup>89</sup>. In this scenario, the distribution of PEPPs would thus be essentially subject to national sectoral law. This would result in a patchwork of national distribution rules providing different standards on key aspects such as advice, disclosure of information or inducements. For PEPP savers, this would mean that for the same PEPP, depending of the type of provider and the Member State of sale, there could be different applicable distribution rules. In addition, Option 1 would entail varying degrees of consumer protection.

<sup>89</sup> Under Article 2(17)(c) of IDD, "pension products which, under national law, are recognised as having the primary purpose of providing the investor with an income in retirement, and which entitle the investor to certain benefits" are excluded from the scope of the distribution rules for insurance-based investment products. Article 2(2)(e) of the PRIIPs-Regulation excludes the same pension products from the scope of that Regulation (see, however, the review clause in Article 33(2)). PEPPs would also not be covered by MiFID II since they would not qualify as financial instruments within the meaning of Article 1(1) in connection with points (1) and (2) of Article 4(1) of MiFID II.

Under Option 2, a specific distribution regime, would ensure a level playing field between the different groups of distributors selling a PEPP. However, a fully mandatory stand-alone regime might be seen as excessively burdensome for both providers and supervisors, and incompatible with the general character of the PEPP as a flexible and voluntary regime based on a limited set of common standards. Furthermore, a full stand-alone regime would result in unequal treatment between PEPPs subject to EU distribution rules and national pension products which would remain subject to national distribution rules. This could negatively affect the take-up of PEPPs and the choice of PEPP savers.

Option 3 would build on the applicable sectoral rules and provide a limited set of PEPP-specific add-on provisions on key distribution features like advice and disclosure of information to PEPP savers. These targeted add-on rules would only apply to such distributors which are not already subject to comparable rules under EU distribution legislation applicable to them (such as IDD for insurance distributors or MiFID II for investment firms). They would thus ensure the necessary degree of coherence between sectoral regimes allowing PEPP savers to compare PEPPs from different distribution channels and make an informed choice with the certainty that they get a minimum standard of advice and information. At the same time, the general distribution regime would still be determined by the applicable sectoral law, acknowledging the diversity of applicable regimes and ensuring, insofar as possible, a level playing field between PEPPs and national products sold by the same providers.

The preferred policy option consists in the application of existing sectoral rules combined with a strictly limited set of PEPP-specific add-on provisions to strike the right balance between, on the one hand, the need for standardised distribution rules setting standards for the specific features of PEPPs, and, on the other hand, a flexible regime that allows PEPPs to fit into existing distribution systems on an equal footing with national products. During the public consultation, providers and consumer organisations favoured building on existing harmonised regimes when designing distribution rules for the PEPP. This option is also consistent with the EIOPA technical advice which favours a sectoral approach and non-advised distribution for the default option. EIOPA considers that the existing regimes would benefit from specific add-ons to cater for specific features of pension products.

The add-on provisions would essentially cover the rules for advice, where the PEPP framework would build on existing sectoral EU legislation requiring an assessment of the investor's financial situation and investment objectives with the possibility to buy the PEPP in its low-risk default version without advice. They would further include rules on pre-contractual product information and inducements. A more detailed description of possible add-on provisions can be found in *Annex 8*.

In terms of effectiveness, this option is compatible with the objective of enhancing cross-border provision and portability of the PEPP, since the existing providers would not be obliged to change profoundly their distribution rules whenever a provider or a saver decides to go across borders. This option also is cost efficient, as not involving the great costs required for adaptation to entirely new rules, and is coherent as it relies on the existing EU rules, slightly adapted if necessary.

#### 4.2.2. Investment policy

##### (a) Investment options for PEPP savers

In view of the long-term retirement objective of the PEPP framework, the investment options granted to the PEPP savers should be framed. These cover the elements allowing investors to make an investment decision, including the number of investment options they can choose from, the need to introduce a default option, the moment when they can select and modify their preferred option, and finally the way to protect their investment over the PEPP lifetime.

After the initial choice made upon the subscription of a PEPP, the PEPP framework could foresee the possibility for the PEPP saver to modify this choice at reasonable intervals, e.g. once every five years, in order to offer sufficient stability to providers for their long-term investment strategy whilst at the same time ensuring sufficient investor protection. Allowing different investment options ranging from a more defensive to a more yield-focused strategy builds on the five PPPs with the highest penetration index.

In this regards, different techniques ("risk-mitigation techniques") can be used by the provider to reduce the investment risks over the PEPP lifetime and provide capital protection. The 'life cycling technique' consists of automatically adapting the portfolio mix towards safer assets once the PEPP saver nears retirement. Alternatively, a capital protection can ensure that the PEPP saver recoups his/her capital.

Alternatively, a life cycling approach, typically offered by asset managers, provides a chance for higher yield compared to a guarantee, typically offered by insurers or pension funds<sup>90</sup>. A capital protection of a purely financial nature (i.e. not containing e.g. death coverage) could be offered by any type of providers, including banks<sup>91</sup> or investment firms.

During the public consultation, individual respondents and consumer associations called for a simple personal pension product which includes a default investment option. The predominant view among insurers and their associations was that a default investment option should provide simplicity and safety and a guarantee on capital and on returns was mentioned as a type of protection attached to the default investment option (this choice to be left to the consumer). Asset managers, on the other hands, stated their preference for other types of risk mitigation techniques, such as life cycling.

The following options may consequently be envisaged:

Policy option	Description
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<sup>90</sup> See EIOPA technical advice, p. 50: *"EIOPA believes PEPP should include high level investment principles which PEPP providers must adhere to and a set of mandatory conditions on the investment options where each PEPP must include [...] in particular for the default investment option, an appropriate investment strategy that links the accumulation of funds via PEPP with the objective of generating future retirement income. Such investment strategies typically entail a de-risking strategy or other relevant long-term investment strategies, or a guarantee, optimising future retirement income by weighing risks and returns in the economic and environmental context. These conditions seek to mitigate potential issues of loss and regret aversion."*

<sup>91</sup> However banks would not be well-placed to participate as providers, as the type of Asset Liability Management commitments implied by fund management are not easily compatible with bank balance sheets.

1. Existing EU sectoral legislation applies, or if absent national legislation	No requirements for risk mitigation.
2. Type of investment protection <b>mandated</b> for the default option, <b>left to providers</b> for the other options	Require a specified risk-mitigation technique for the default option, such as a e.g. financial capital protection to at least recoup the capital invested. The statute would also require the use of a risk-mitigation technique to the choice of the provider for the other investment options.
3. Type of investment protection <b>mandated for all</b> investment options	Require a specified risk-mitigation technique for all investment options, such as a e.g. capital protection to recoup the capital invested.

Under Option 1, the risk mitigation techniques are set a national level or by the provider. In case no such technique is included in the PEPP, the attractiveness of the PEPP among PEPP savers would be limited, if no protection were provided to retail investors. Moreover, in some Member States, products without any guarantee would not qualify for national tax incentives. This option appears as not protective enough for PEPP savers. It also bears reputational risks for the PEPP framework, in case of bad returns on investments.

Option 2 would provide additional consumer protection, encouraging further investments through PEPPs in the CMU context. The choice of a robust capital protection, such as a guarantee or life-cycling, to recoup at least the capital invested would indeed allow creating a simple product, in line with the retirement objective. Retail investors looking for more yields could opt for alternative investment options, which would still benefit from a risk mitigation technique. The PEPP framework would also benefit from a clear default option, which would be likely to increase its visibility with both PEPP savers and providers. Finally, regarding the cross-border dimension, standardisation of at least the default option would contribute to portability and cross-border provision.

Option 3 would not contribute to establishing a level playing field between different types of providers. It would reduce the choice of investment options for PEPP savers, in particular for those willing to take on more risk in order to target a higher return. These aspects could result in a reduced take-up of the PEPP, and thus fewer investments in the CMU context. On the other hand, cross-border development may be encouraged thanks to higher standardisation.

Accordingly, Option 2 balances the need for investment protection with choice for PEPP savers and is hence recommended. This option demonstrates effectiveness in achieving the objective to enhance the take-up of the PEPP by allowing great flexibility of choice for the savers. The option is cost efficient, since the greater costs associated with a robust capital protection could be avoided if the investor chooses some of the alternative investment options. Finally, this option is coherent with other EU policies, and thus politically feasible, as in line with existing EU financial rules to protect savers.

#### (b) Investment rules for PEPP providers

The following options are considered.

Policy option	Description
1. Existing EU sectoral legislation applies, or if absent	No investment rules for PEPP providers. They would follow existing sectoral rules.

national legislation	
2. Introduce a general principle of prudent investment	PEPP providers would be free to invest while respecting some general principle of prudent person or being subject to specific restrictions, e.g. on the use of derivatives.
3. Introduce investment targets	Introduce granular investment targets and limits, requiring investment in certain long term illiquid assets and in some liquid assets allowing for redeemability.

Under Option 1, providers continue to comply with existing sectoral rules and no additional rules would be introduced. As a consequence, providers would not face additional compliance costs and no PEPP specific investment policy would have to be observed. However, in this option the least effect is achieved in terms of creating a level playing field between providers of different sectors, since different rules will apply for offering the same product by a different type of provider. Also, from a prudential as well as a customer protection perspective, pursuing this option offers minimal safeguards whereas the retirement objective and the general reputation of a product require otherwise.

Option 2 would consist of including the prudent person principle for PEPP providers, as in Solvency II<sup>92</sup> or IORP II for insurers and occupational pension funds, or the rules applicable in the respective sectoral legislation of the provider. This principle consists in particular of ensuring sufficient asset diversification, or investing in line with the long-term duration of the liabilities for pension products. In the abovementioned EU legislation, the prudent person principle has shown that it can deliver positive results when properly implemented by providers. Providers could be invited to take into account on a voluntary basis environmental, social and governance factors, and would have to disclose it to PEPP savers. The underlying principle would be that the provider has to know the risks of the assets in which investment is made and be able to demonstrate to supervisors that sound risk management is in place. Further restrictions could ensure a sound investment policy, such as allowing investments in derivatives only if they contribute to a reduction in investment risks or facilitate efficient portfolio management<sup>93</sup>.

This option establishes a level playing field between different types of PEPP providers. In addition, it achieves equal level of customer protection with the existing harmonised regimes.

Option 3 would increase the level of detail on investment rules by indicating targets for investments in e.g. infrastructure. Further, some absolute limits could be imposed on riskier investments to ensure adequate consumer protection. Finally, in order to combine

<sup>92</sup> See Article 132 of Directive 2009/138/EC

<sup>93</sup> See for instance IORP II Directive, Article 19(e): *"investment in derivative instruments shall be possible insofar as such instruments contribute to a reduction in investment risks or facilitate efficient portfolio management. They must be valued on a prudent basis, taking into account the underlying asset, and included in the valuation of an IORP's assets. IORPs shall also avoid excessive risk exposure to a single counterparty and to other derivative operations". A further example can be found in Article 50(1)(g) of Directive 2009/65/EC of the European Parliament and the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS V").*

the need for long-term illiquid investments and some strictly limited redeemability, minimum liquidity requirements could be imposed, following the precedent of the ELTIF Regulation. In this option, the highest prudential and customer protection effect is achieved by specifying in detail the risks that should be avoided. On the other hand, providers and probably PEPP savers would be faced with higher costs on the product, affecting take up, mostly due to investment losses and compliance costs.

Option 2 ensures appropriate balance between the costs and return of the product and provides consumer protection; it is hence recommended. By introducing the prudent person principle for PEPP providers this option is effective (since the PEPP savers' increased confidence in the providers would enhance the take-up of the PEPP), cost efficient (reducing compliance costs as a result of the general freedom of PEPP providers to invest) and coherent with other EU policies encouraging in particular consumer protection. Finally, it is politically feasible, as it is in line with EU legislation in application in the area of financial services.

#### 4.2.3. *Rules on switching providers*

Switching is defined for the purpose of this impact assessment as changing providers, within the same Member State or across borders.

During the Public Consultation, respondents quoted high costs and charges by personal pension providers as a key concern. In particular, individual respondents to the consultation insisted on being able to switch providers in order to not be locked in, for instance in case of bad net performance of the investments made by the provider. On the other hand, the majority of professional stakeholders, mainly insurers and pension funds, believe that switching should be only possible after a minimum lifetime of the product and allowed only a limited number of times, while cost and fees should be left to competition between providers. Less are those – mostly trade unions and think tanks – considering that switching should be possible without conditions. They usually declare full support for consumer mobility and freedom for savers to consolidate their savings.

Switching providers entails high costs for the provider as it undermines the possibility for illiquid investments, and may thus require some liquidity buffer in the PEPP, which may be transferred to investors in the form of fees or lower performance. One study in the UK<sup>94</sup> estimates the costs of switching from 1% up to 5% of assets under management. Therefore, a first question is under which frequency and key conditions switching should be allowed. In order to provide sufficient illiquidity to the investment, a possibility could be to strictly frame the option to switch providers over the duration of the PEPP contract.

A second question concerns the cost of switching. In this aspect the following options can be examined:

<b>Policy option</b>	<b>Description</b>
1. Existing EU sectoral legislation applies, or if absent national legislation)	No requirements for switching.
2. Switching without costs	Allow switching at zero cost.
3. Switching with costs	Allow switching but do not regulate costs.

<sup>94</sup> Source: [www.boards.ie](http://www.boards.ie) available at: <https://www.boards.ie/b/thread/2057584106/2>

Option 1 would imply not addressing one of the basic concerns expressed by the PEPP savers and consumer organisations in the public consultation. As the PEPP is a retirement product, it would imply that PEPP savers may be locked in over a very long period if the provider does not allow switching on a contractual basis.

Under Option 2, the prohibition of any exit costs (even covering nothing more than the actual expenses incurred by the provider) risks deterring providers from offering PEPPs, or would provide incentives to charge PEPP savers through other means (e.g. administration fees).

Option 3 may render the switching disproportionately burdensome (i.e. costly) for PEPP savers and in practice make switching so expensive that it would not be possible for them.

Option 4 would contribute to boosting competition whilst at the same time protecting PEPP savers from excessively penalising exit charges (thus the option is coherent with the general EU policies aiming at protecting PEPP savers). It is likely to foster take-up of PEPPs (being both effective with respect to this objective and cost efficient – enlarging the customer base and thus reducing providers' costs), through a balanced capping of the exit charge in order to attract both providers and PEPP savers. As the PEPP would be offered by a wide range of providers, new market entrants could benefit from the opportunities of switching provider. For PEPP savers this would allow to benefit effectively from the competitive advantages of a wider range of providers, with the possibility to monitor and compare performance and if necessary change provider. In addition, capping charges is likely to encourage cross-border development as PEPP savers would also consider switching to providers established in another Member State. Finally, it appears as politically feasible as long as the capping can be properly calibrated, e.g. through principles in the PEPP framework. Option 4 is consequently recommended.

#### 4.2.4. *Cross-border provision and portability*

The cross-border dimension of the PEPP can be developed at the level of the provider (passporting) and at the level of the PEPP saver (portability). At the provider level, firms benefitting from a passport for cross-border services (for example, under MiFID or Solvency II) would be able to supply PEPPs cross-border. Portability is meant here as a mechanism allowing the PEPP saver to keep the same provider when changing Member States (ideally with the right to transfer accumulated rights between national compartments of a same product, without having to liquidate the assets or keep open all the national compartments where past contributions have been made).

During the Public Consultation, industry stakeholders identified as main barriers to portability the differences in the regulation of pension contributions and in tax rules, the language and informational barriers, as well as the exit costs for personal pension products. Academics considered that portability is not always compatible with the nature of the pension product for technical reasons.

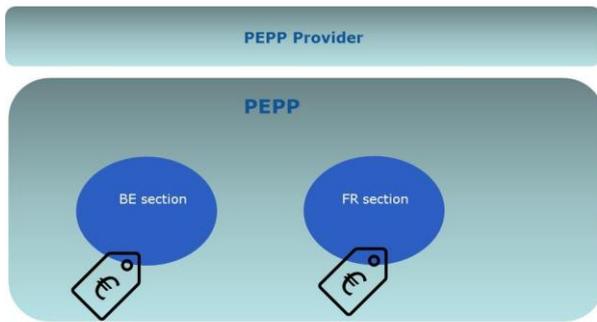
In this regard, the following options can be envisaged:

Policy option	Description
1. Existing EU sectoral legislation applies, or if absent national legislation	No specific provision on cross-border portability and supply.
2. Enhanced cross-border portability (allow transfer of assets between sections)	Allow continued contribution to a PEPP in the context of mobility through the creation of a new national compartment if the investor moves to a new Member State. In addition, it allow transferability of assets between sections within a PEPP.

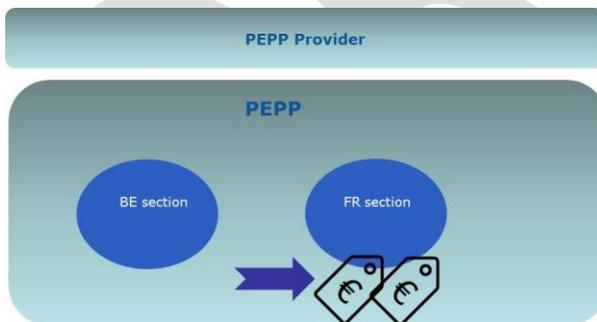
Option 1 leaves without a regulatory response one of the main concerns of mobile workers in the context of PPPs – how to preserve the relationship with the provider while exercising cross-border mobility. Under this option, the cross-border dimension of the PEPP, would not be significantly different from existing national personal pension products, either for providers or savers. In addition to not addressing the cross-border objective of the PEPP initiative, Option 1 may also result in a limited effect on investments in a CMU context, as the PEPP would be directly competing with national products.

Options 2 provides more PEPP saver portability through a "section approach": each national compartment would reflect the PEPP product features selected in the new Member State of residence, within the same PEPP. 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.

Under Option 2 (*see illustration below*), a new section could be opened following mobility. The PEPP framework could include rules to standardise the exchange of information between the supervisors concerned and would ensure continuous information to the PEPP saver about the pension accumulated and to be accumulated in the home and host Member States. It would also allow the provider to build economies of scale.



In addition, enhanced portability is conferred to the product by allowing the transfer of assets between national compartments without obligation to liquidate the assets. It could mitigate the consequences of minimum duration requirements in various Member States which hinder PEPP saver take-up, by permitting the consolidation of assets in a single section. This would mean for the PEPP saver one single sum accumulated, benefitting from one set of national requirements e.g. on when to start decumulation. Accordingly, this would come closer to achieving a simple and portable PEPP product, and thus reach the objectives of cross-border development and take-up. However the transfer of assets could entail significant costs pertaining notably to tax exit charges. Indeed, EET Member States which provide exemptions during accumulation but not decumulation might impose an exit tax on an individual wishing to transfer his pension to another section, as it would imply losing on tax revenue over the decumulation period. However, according to ECJ case-law, such taxation could infringe the principle of non-discrimination under Article 45 TFEU and Article 7(2) of Regulation No 1612/68 where it results in an indirect discrimination of migrant workers. The Court has also emphasised that "*provisions preventing or deterring a national of a Member State from leaving his country of origin, and thus from exercising his right to freedom of movement*" are not compatible with the Treaty<sup>95</sup>.



Accordingly, Option 2, which offers most possibilities for mobility both to providers and to PEPP savers, through the coexistence of national compartments or the transfer into a new compartment, is recommended. From the perspective of providers, it may result in some added complexity with the task to create compartments and ensure transfers. However, from the perspective of PEPP savers it results in a simpler product with continuity in a context of mobility and the guarantee to receive consolidated information about all national compartments in one piece.

<sup>95</sup> ECJ C-269/07, judgment of 10.9.2009, *Commission v Germany*, point 107. The Court explicitly rejected the argument of a loss of future tax revenue, see point 105.

This option is effective, as it would enhance the portability of the PEPP and thus contribute to increased investments in the CMU context. It is cost efficient, as it may result in significant economies of scale. Finally, it is coherent with other EU policies, and politically feasible, as it contributes in particular to establishing a genuine single market to the benefit of PEPP savers.

#### 4.2.5. *Decumulation*

This section covers both the moment at which PEPP savers would make the choice of the decumulation options and the type of decumulation they could opt for.

On the timing, PEPP savers could have to decide upon subscription of a PEPP about their pay-out choice (annuities, lump sum, other), but with a possibility to revise their choice once every five years to allow PEPP savers to change their pay-out choice when they near retirement.

The type of decumulation – annuities, lump sum or regular withdrawals, or a combination of these - is linked to the beneficial tax treatment provided to personal pension products in certain Member States<sup>96</sup>, where annuities may not be **legally** a mandatory option, but **tax benefits** seem to be linked with the use of annuities in decumulation. According to the Interim Report, for the purpose of using tax relief:

- PPP schemes in three Member States (Austria, the Netherlands<sup>97</sup> and Slovenia) require annuities for out-payments in the decumulation phase;
- PPP schemes in two Member States (Cyprus and Malta) require lump sum;
- PPP schemes in thirteen Member States allow for both annuities and lump sums to benefit from tax incentives.

In yet other Member States the out-payments are taxed, whatever the decumulation option (annuities, lump sum, or a combination of both).

On the other hand, according to the Interim Report, annuity is legally mandatory for nine PPP schemes in six Member States (Denmark, Finland, France, Germany, the Netherlands and Sweden). However, they do not lead to tax incentives, apart from the Dutch PPPs.

During the Public Consultation, the predominant majority of the professional stakeholders advocated in favour of flexibility in the decumulation phase to be able to adapt to different consumer expectations across the EU. Insurers and occupational pension funds, typically provided annuities, pleaded in favour of annuities. Trade-unions and consumer representatives also favoured annuities, to secure income in retirement and avoid that assets be prematurely exhausted. Insurers also pointed to the fact that sharing biometric and financial risk during the pay-out phase (within insurance collective and over time) increases predictability and stability of retirement income streams for consumers.

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<sup>96</sup> EPPF Study, Interim Report.

<sup>97</sup> In the Netherlands, however, annuities are legally the mandatory form of decumulation.

EIOPA advised that, due to national specificities, standardization is best achieved in the accumulation phase and that consequently, decumulation is left flexible<sup>98</sup>.

The following options for the type of decumulation may be considered.

Policy option	Description
1. Existing EU sectoral legislation applies, or if absent national legislation	No requirements on the form of decumulation.
2. Mandate a decumulation option	Only one specific decumulation option (e.g. annuities) would be allowed.
3. Mandate flexibility of decumulation	PEPP providers should be allowed to develop all possible types of decumulation.

Option 1 allows the necessary flexibility to feature the specificities of the national personal pension markets. However, this option – by perpetuating different national approaches – would prevent providers from choosing between all available decumulation options.

With a view to the specific retirement objective of the PEPP framework, Option 2 would entail that decumulation be exclusively made via annuities. This would ensure that in savers would obtain direct income tax incentives in those Member States with legal requirements limiting the out-payments to annuities. Furthermore, Option 2 would ensure that PEPP savers benefit from a regular income in the form of annuities over the whole retirement period. However, such option implies additional. In addition, this option would restrict the PEPP market to insurers, occupational pension funds<sup>99</sup> as other types of providers cannot offer annuities. Such providers, such as asset managers or investment firms would either have to have an insurance license, or establish specific arrangements with insurers to be able to provide annuities. This might hinder the take-up of the PEPP by such providers. As a consequence, this option might limit supply of the PEPP.

Under Option 3, whilst the determination of the moment triggering decumulation should be left to national legislation, in light of the variety of schemes and national preferences, as well as in order to establish a single market for personal pensions, the PEPP framework would allow providers to offer decumulation via annuities, a lump sum or other forms such as regular withdrawals ("drawdowns"), hence allowing the necessary flexibility to feature the specificities of the national personal pensions markets.

Option 3 would allow providers to choose between all available decumulation options and is hence recommended. This option is effective in achieving the goal of enhanced take-up of the PEPP through increased flexibility and choice for PEPP savers. It is cost efficient as it allows providers to design their products in the most cost-effective way. It is coherent with other EU policies, and politically feasible, as it preserves enough flexibility for Member States to decide about which decumulation options they wish to encourage.

<sup>98</sup> See EIOPA technical advice, p 54.

<sup>99</sup> Annuities require to calculate a monthly payment over the lifetime of the saver, implying a biometric component (based on e.g. mortality tables), and they can thus only be offered by insurers and pension funds.

4.2.6. *Summary of the recommended PEPP key features – how would a PEPP function in practice ?*

The PEPP framework, based on the recommended options above, would allow PEPP savers to benefit from simple, transparent, cost-effective PEPPs. PEPPs would be distributed following the existing sectoral EU legislation (MIFID II and IDD), with specific add-ons in particular to encourage online distribution, to allow for non-advised sale for the low-risk default investment option, and to adapt information requirements to the nature of this retirement product, building on the PRIIPs Regulation. Retail investors would be able to choose from a limited set of investment options, all with investment protection techniques to ensure sufficient safeguards, with the default option as a particularly safe investment policy. Providers could invest in various types of assets provided they respect the prudent person principle. The PEPP framework would allow PEPP savers to switch providers regularly, with a cap on exit costs. Retail investors would be able to take their PEPP to other Member States, through contributing to a new national compartment or by transferring their assets into this new section, subject to costs. Finally, they could opt for several decumulation options and change their preferred option regularly in order to benefit from sufficient flexibility.

This set of key features mirrors the best practices observed in the five PPPs with the highest penetration index, as illustrated in the table below.

**Table 4: Comparison of the PEPP with national products with the highest penetration index**

Coded name		Belgium	Denmark	Germany	Austria	Spain	PEPP
		PP	RP	Riester	PZV	IPP	
<b>Investment policy</b>							
<b>Investment strategy</b>	Multiple investment strategy available	×	×	×	×	×	X
	The product allows for choosing a more aggressive or defensive investment strategy	×	×	×	×	×	X
	It is possible to change the investment strategy during the lifetime of the product	×	×	×	×	×	X
	De-risking investment option close to retirement age	×	×	×	×		X
<b>Mitigation of return risk</b>	The product provides for capital protection:	×	×	×	×	×	X
	The product could provide death coverage	×	×	×		×	X
	The product provides disability allowance		×	×		×	allowed
			optional	optional		optional	ed

Coded name		Belgium	Denmark	Germany	Austria	Spain	PEPP
		PP	RP	Riester	PZV	IPP	
<b>Decumulation features</b>							
<b>Out-payments characteristics</b>	Early out-payment possible	×	×	×	×	×	X*
	There is a minimum age limit for the start of the decumulation phase	×	×	×			NA
	No unique mandatory option	×		×	×	×	X
<b>Provider switching</b>							
<b>Domestic switching providers</b>	Switching providers in the same MS without tax impact	×	×	×	×	×	X
<b>Cross border switching providers</b>	Switching providers to another MS without tax impact	×	×	×			X
<b>Distribution features</b>							
<b>Distribution channel</b>	Banks	×	×	×		×	X
	Insurance network		×	×	×	×	X
	Asset Managers						X
	Advice is available to individuals online	×	×	×	×	×	X
<b>Cross border activity features</b>							
	Having the nationality of the relevant Member State or a physical address in the Member State is not a requirement to buy the product	×	×	×	×	×	X
<b>Treatment of providers features</b>							
	Providers from other Member States/EEA are allowed to sell the PPP	×	×	×	×		X

\* Limited circumstances such as exceptional case of hardship.

In addition, the PEPP features provide additional benefits, on a pan-European basis, to those observed in some PPPs. In contrast with national PPPs, providers would benefit from an EU passport which would allow benefitting from an EU market for personal pensions. As to PEPP savers, the PEPP allows for more choice for PEPP savers from more various types of providers. It also contains enhanced distribution rules, in particular to ensure adequate pre-contractual advice. In particular, the PEPP framework would provide full transparency on costs and fees, rules on disclosure of information, portability and a right to switch, with capped costs.

In practice, regarding the implementation of the PEPP framework, a provider would have to be already authorised under EU rules (e.g. Solvency II, UCITS, etc.) to provide a PEPP. It would then seek a product authorisation to manufacture the PEPP from EIOPA, which would be granted in coordination with the other European Supervisory Authorities. EIOPA would verify the compliance of the product with the requirements set out in the PEPP statute, as regards distribution, investment rules, portability, switching and decumulation. EIOPA would publish the list of authorised entities. Upon authorisation, the PEPP manufacturer could then distribute the PEPP itself or have it distributed by another undertaking authorised under EU rules.

As regards portability, a single PEPP would comprise of national compartments. Each compartment would accommodate for the tax critical product features of a specific Member State allowing that contributions qualify for national tax relief.

At the level of an individual PEPP saver, a first compartment would be created upon opening of the account. Each time the PEPP saver changes his residence to another Member State, a new compartment would be created in his PEPP account.

At the level of the PEPP scheme, the funds of the different compartments can be pooled in one large asset pool for the investment strategy. The PEPP would create the right for a PEPP saver to open a new compartment when exercising mobility.

When changing residence a PEPP saver would have two options (see above in section 4.2.4). Firstly, a PEPP saver could maintain multiple compartments. On retirement, the PEPP saver would have different income streams in accordance with the modalities of each compartment. Alternatively, a PEPP saver could transfer assets between compartments when changing residence, resulting in one single income stream on retirement. The PEPP would establish the right to transfer accumulated rights between national compartments of a same product, without having to liquidate the assets. However, the transfer of assets could entail significant costs pertaining notably to tax exit charges. For PEPP providers, portability would mean that provider needs to administer for the tax treatment of compartments covering all Member States. The underlying assets can be pooled across all compartments and PEPP savers and would allow creating economies of scale.

#### 4.2.7. Tax treatment based on the recommended PEPP key features

Taking into account the key features of the recommended PEPP option presented above, this section presents and analyses three options to deal with taxation:

Policy option	Description
1. Baseline (national tax treatment)	The baseline scenario applies. The tax treatment would depend on product requirements set at national level
2. Favourable tax treatment	The Commission would recommend to national authorities to provide national tax treatment to PEPPs even if they do not match all relevant national criteria
3. PEPP specific tax regime	Create a specific EU tax regime for the PEPPs

#### **Option 1: Baseline scenario – National tax treatment**

Under this option, each national compartment of a PEPP would implement the key features required by national tax rules for the domestic PPPs. Cross-border in-payments to a PEPP would be paid into the section for that PEPP. These in-payments paid to a foreign PEPP provider would qualify for the same tax relief as in-payments paid to domestic providers. Yields during accumulation phase would qualify for the same tax relief as yields received on pension products from domestic providers. ETT Member States, i.e. Member States that levy a yield tax on the investment results during the accumulation phase of the contract should be able to continue to levy their yield tax also when the provider is established in another Member State, since the foreign provider would have to follow the same yield tax rules for the section for the yield tax Member State. Out-payments would qualify for the same tax treatment as out-payments received from domestic providers.

#### **Assessment**

This option would not require any change of existing legislation. Where necessary, the Commission would enforce the national tax treatment principle by launching infringement procedures, if a Member State would not grant national treatment to PEPPs matching all relevant national tax criteria. Under the preferred approach for the key PEPP features, as described above, providers would be able to adapt most of features to the national criteria and thus benefit from the tax incentives in many Member States. Therefore, although cross-border portability or provision would be limited under this option<sup>100</sup>, the take-up of the PEPP should be encouraged in the Member States where providers can reap the national tax incentives.

However, this would not be the case in all Member States. For instance, under the semi-defined approach, the PEPP framework would establish the possibility of switching, i.e. intra-Member State switching of provider for non-mobile persons. This might lead to some Member States refusing to give national treatment to the PEPP, since their current PPP regimes do not allow switching. Indeed, regarding domestic switching, based on 49 existing PPPs, under three PPP schemes in three Member States (Belgium, Latvia and Luxembourg) domestic switching leads to immediate taxation, and under five PPP

<sup>100</sup> Cross-border portability would be ensured in those cases where Member States currently offer cross-border portability, on condition that national anti-abuse provisions were followed by the PEPP, as for domestic PPPs.

schemes in four Member States (Cyprus, Germany, Malta and Slovakia) domestic switching is not possible<sup>101</sup>. As another example, the semi-defined approach of the PEPP would also define the investment policy options. It is possible that some Member States would consider the PEPP investment policy as too different from their domestic investment policies, so they might also refuse national tax treatment to the PEPP. The Commission would, on a case-by-case basis, assess whether any refusal of national treatment was indeed proportionate and could possibly launch infringement procedures.

### **Option 2: Favourable tax treatment:**

Under this option, Member States would be invited to provide the same direct income tax advantages that are provided to qualifying national PPPs, even if the product features under the PEPP framework do not match all relevant national criteria for tax incentives (see above the example of provider switching).

Such an initiative could take the form of a Commission Recommendation, adopted alongside the proposal for a legislative statute. The Commission would, three years after the entry into application of the statute, review the application by Member States of the Recommendation, assess the situation on the PEPP market, including any possible distortion of competition between the PEPP and available national PPPs, and possibly consider new initiatives.

Beyond the application of the national tax treatment principle (See Option 1 above), a Recommendation could invite Member States to extend national tax incentives to PEPPs, even if the PEPP features do not match all national criteria. A Recommendation could also invite Member States to consider aligning some national tax criteria.

### **Assessment**

Following EU-level definition of certain features of the product and **on the condition that, following the Commission Recommendation, Member States would provide on a voluntary basis national tax incentives** to the PEPPs even if they do not match the national criteria, this option would put the PEPP at equal footing with national PPPs.

Over a long term perspective, gradual market adoption would contribute to more investments into a PEPP as compared to the baseline scenario, substituting to some extent other household financial assets (e.g. deposits, investment products or PPPs). This would contribute, as one project among others, to the development of a CMU.

However, the implementation of Commission Recommendations in national law is subject to unilateral decision by each Member States and there is no such precedent in the area of direct taxation. Only interpretative Communications based on Court case-law have so far impacted on Member States' direct tax rules<sup>102</sup>.

The fiscal benefits are deemed very important by all types of organisations who responded to the public consultation, representing different sectors. The market seems to organise itself around tax benefits – a powerful tool to incentivize citizens to save for retirement. Favourable tax treatment by means of a specific PEPP tax regime is preferred

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<sup>101</sup> EPPF Study, Interim Report.

<sup>102</sup> See, for example, the Pension Taxation Communication of 2001 and the Dividend Taxation Communication of 2003.

by market participants. Nevertheless, market participants showed interest in the PEPP even without tax incentives.

### **Option 3. Specific tax regime:**

Under this option, a specific tax regime would be created by legislation at EU level, granting a specific tax advantage to PEPPs across the EU; thus, in different Member States higher or lower than the tax advantages granted to qualifying national pension products. This option, ideally combined with a PEPP of which all tax-critical features are defined at EU level, would be designed as part of the same or of a separate EU initiative.

Within this option, a relevant sub-option consists of fully harmonised PEPP key features with a specific limited tax advantage which would be inferior to the national tax incentives.

### **Assessment**

Under this option, PEPP savers would benefit from tax incentives for PEPPs throughout the EU. However, the tax incentives could be defined independently of the tax incentives already applicable for existing PPPs in Member States. New or additional tax incentives could be introduced in those Member States where they are currently absent<sup>103</sup> or insufficient, **stimulating further the completion of the CMU and the creation of a simple, transparent, high-quality PEPP by standardising its key features**. Option 3 would also facilitate cross-border provision of a PEPP and confer full portability to the product. Among the three options, this option would best contribute to achieve the abovementioned objectives as no flexibility of the PEPP features would be necessary. In particular, in the sub-option presented above, the PEPP would be able to reap the benefits of full harmonisation of its key features, even if competing with exiting PPPs with an inferior tax incentive would result in more limited uptake.

However, establishing a harmonised tax treatment requires unanimous agreement among Member States. The prospect of potential lower tax revenues in at least some Member States – unless calibrated at a level higher than the highest tax advantages in any Member State – or the potential need to create a specific tax regime, seriously jeopardizes the potential of success of any such initiative. Indeed, during the consultative meeting with Member States' tax experts on 2 March 2017 several Member States stated their opposition to any such harmonisation.

### **Comparison of policy options**

<i>Objectives</i>	<i>EFFECTIVENESS</i>			<i>EFFICIENCY</i>  <i>(cost-effectiveness)</i>	<i>COHERENCE</i>	<i>POLITICAL FEASIBILITY</i>
	<i>Objective 1</i>	<i>Objective 2</i>	<i>Objective 3</i>			
<i>Policy option</i>	<i>Increase investment in the EU and complete the</i>	<i>Enhance product features on the personal</i>	<i>Enhance the cross-border provision and portability of personal</i>			

<sup>103</sup> According to the consultant's research (EPPF Study), the only PPP scheme in Sweden is without any tax relief (i.e. it is a "TTT" scheme).

	CMU	pension market	pension products			
<b>Option 1</b> <i>No policy change – National tax treatment</i>	0	0	0	0	0	0
<b>Option 2</b> <i>Favourable tax treatment</i>	+	+	+	+	0	+
<b>Option 3</b> <i>PEPP specific tax regime</i>	++	++	++	-	++	--

*Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable*

Given the importance of the tax element, as documented in the EPPF study, option 3 would be from an economic point of view the most effective option in reaching the objectives of this initiative.

However, its political feasibility seems at the current juncture rather uncertain. On the contrary, option 2 is politically feasible as it does not require unanimity among Member States: only Member States willing to extend the benefits of national tax incentives to PEPPs even if they don't match all national criteria would do so. A staggered approach is also feasible, whereby Member States progressively apply Option 2 over the years.

Regarding options 1 and 2, in spite of the uncertainty about how many Member States would be ready to follow a tax recommendation, we would recommend following option 2. Indeed, granting favourable tax treatment in a number of Member States could only be beneficial for the development of the PEPP, in addition to only applying the national tax treatment principle (option 1). The related PEPP proposal would thus be accompanied by a tax recommendation in order to maximise the development of the PEPP over the coming years.

On the basis of the PEPP key features and recommended tax approach, we summarise in the Box below why the PEPP would be a simple, transparent, cost-effective and innovative product, in particular as compared to existing PPPs.

### **Box 3 - The PEPP: a simple, transparent, cost-effective and innovative product**

#### **Simple**

##### ***For PEPP savers***

- Up to five investment options only;
- Default investment option mandatory, aiming at ensuring that at least the invested capital is recouped;
- Enhanced portability provisions: the PEPP saver is able to keep the same provider when changing Member State and to receive consolidated information about all contributions across the EU;

##### ***For PEPP providers***

- A simple set of rules thanks to standardisation focusing on distribution, consumer information, investment options and decumulation;

- One single product authorisation for the whole EU;
- Online distribution is made the default distribution channel: providers can enter the PEPP market without a network of branches;
- Streamlined exchange of information between national authorities when the PEPP provider distributes the PEPP in a new Member State;

### **Transparent**

#### *For PEPP savers*

- Robust pre-contractual information through a PEPP KID including full disclosure on costs, and
- Regular information during the accumulation and decumulation phases;

#### *For PEPP providers and national competent authorities*

- Central public register;

### **Cost-effective**

#### *For PEPP savers*

- Full transparency on costs, right to switch providers and cap on switching costs bring costs down for PEPP savers;
- Increased number of potential providers, hence increased competition (asset managers, banks, occupational pension funds, MIFID firms and insurers);

#### *For PEPP providers*

- Economies of scale possible thanks to standardisation; online information and online distribution;
- Possibility to develop larger assets pools thanks to standardisation and a single pan-European market.

### **Innovative**

#### *For PEPP savers*

- Easy access to PEPPs through online information and online distribution, including advice, as the default distribution channel

## **5. OVERALL IMPACTS**

### **Overall impact of the preferred option**

Under the preferred option, providers including insurers, pension funds, investment firms, banks and asset managers, authorised under EU sectoral regimes, would be able to design Pan-European Personal Pension Products (PEPPs) based on a set of common features, taking into account national differences due to tax critical features. To that end, providers would create national "sections" of the product, complying with tax-critical features for each Member State where they intend to operate. However, they would be enabled to pool assets and benefit from increased economies of scale due to the common product features such as the default investment option and an easier way of providing services across borders, thanks to common information requirements for instance. It can be expected that more asset managers would enter the personal pension market currently dominated by insurers. Furthermore, it can be expected that providers would increasingly

operate on a more cross-border basis and doing so more effectively benefitting PEPP savers, especially in smaller jurisdictions with limited take-up and product supply.

The PEPP would consist of a limited set of investment options including a prudent default investment option which should cater for a majority of PEPP savers. The investment rules would contain risk-mitigating techniques, which would be specified for the default option (e.g. capital protection to recoup at least the capital invested) and left to the choice of the provider for the alternative investment options (e.g. life cycling, guarantees). The product would include common information requirements providing for good information before signing up to the product, and investors would be informed about key performance indicators of the PEPP throughout its lifetime.

For PEPP savers, the PEPP would provide an additional choice to develop complementary saving for retirement. They would benefit from improved pre-and post-contractual information and they would be enabled (by limits to exit fees) to switch PEPP provider, if for example they consider the performance insufficient.

PEPP Savers would be enabled to choose among different types of providers and compare PEPPs with any national personal pension product. They would benefit from the increased types of providers, as asset managers, pension funds and banks could enter a market dominated traditionally by insurers. This could create more competition in terms of lower costs and fees, increased choice in investment options and possibility could affect returns. Due to the mandated possibilities of switching provided by the statute, they would effectively benefit from the increased competition. A positive effect can also be expected for the self-employed who do not contribute in such capacity to a state-based or occupational pension. The PEPP could complement the existing national personal pension products by offering more choice and increase trust of PEPP savers, through its set of common features. Mobile workers would benefit from this initiative as it would be possible to save for retirement with the same provider in so far as the provider offers sections of the PEPP for different Member States.

The PEPP market potential is currently estimated at EUR0.7 trillion and relies on the favourable assumption that the PEPP would be granted the same tax reliefs as the national products in all Member States (see also section below), which could possibly occur in the long term, over the period 2020-2030. This projection will also depend on the practical supply of the product and take-up by pension savers. Depending on the number of Member States granting favourable tax treatment, and the level of possible tax incentives, the penetration of the PEPP could be slower.

The PEPP market can be expected to develop progressively with the potential to set a benchmark for personal pension products. If successful, the PEPP could reach its market potential over ten years.

### **Macro-economic impacts**

This section outlines the potential macro-economic impacts to be expected over the medium/long term after the introduction of the PEPP first by estimating the likely increase in market-based<sup>104</sup> funding following the personal pension market development after the introduction of the PEPP and secondly by identifying other positive impacts on

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<sup>104</sup> For an explanation of market-based funding see section E of Annex 4.

the welfare of individual households based on a review of the relevant literature. In particular the analysis shows that: i) on the supply side (see below) a successful take-up of the PEPP will contribute to half of the expected growth of the personal pension market in the EU by 2030 and will increase capital markets by up to 2% with tax incentives and ii) on the demand side (see below) the tax relief for private pension products is considered to be a key element to make them attractive and superior alternatives compared to more traditional savings methods.

### **Supply side (increase of market-based funding for the EU economy)**

The personal pension product markets are expected to develop from the current level - estimated at around EUR 0.7 trillion - to either EUR1.4 trillion (which corresponds to the baseline scenario) or EUR2.1 trillion (with the extra amount coming from the PEPP). Assuming that no substitution effects between the former and the latter take place, the PEPP would then account for around a half of a potential increase of the total market, the other half coming from growth dynamics involving the currently sold national products. As also explained in section A and B of *Annex 4*, as tax incentives are the key explanatory variable in the regression analysis performed, it is hence a key assumption behind the estimated PEPP market of EUR0.7 trillion. Moreover, the 95% confidence interval of the market potential is estimated between EUR0.4 trillion and EUR1.0 trillion using the same confidence interval of the fiscal generosity variable. Incidentally, the PEPP market without tax incentives could be expected to be quite low and would see a quite moderate overall take-up as rationally it can be expected only in those member states where tax incentives are not so material and where PEPP better product features can be expected to compensate for the loss of tax benefits.

In order to quantify the extra market-based funding available to the EU economy following the introduction of the PEPP (in case of the mid-point estimate of EUR0.7 trillion), three possible assets allocations were considered. These are described in more detail in section C of *Annex 4* which also explains the rationale behind considering different assets allocations and the methodology/sources used. The results of the three scenarios are shown below in table 1. The difference among the total amount to be invested in a given asset class is then dependent on the actual investment strategy put in place by the PEPP providers: for example, investments in equity would reach EUR 231 billion with the current asset allocation (central portfolio) with an estimated range between EUR 175 billion (conservative portfolio) and EUR 280 billion (growth portfolio). These figures could also be found in the right part of the table where an average of the three scenarios is also provided by giving equal chance to the three scenarios.

Table 5: market-based funding for different asset classes from PEPP in 3 different scenarios and estimated average, lower bound and upper bound values

Extra market-based funding from PEPP (EUR Billion)	Central portfolio		Conservative portfolio		Growth portfolio		Average	Lower bound	Upper bound
<b>Equity</b>	<b>33%</b>	<b>231</b>	<b>25%</b>	<b>175</b>	<b>40%</b>	<b>280</b>	<b>229</b>	<b>175</b>	<b>280</b>
-Listed equity	29%	203	22%	154	34%	238	198	154	238
-Other equity	4%	28	3%	21	6%	42	30	21	42
<b>Debt securities</b>	<b>55%</b>	<b>385</b>	<b>63%</b>	<b>441</b>	<b>46%</b>	<b>322</b>	<b>383</b>	<b>322</b>	<b>441</b>
-Sovereign Bonds	34%	238	40%	280	20%	140	219	140	280
-Financial Bonds	12%	84	13%	91	14%	98	91	84	98
-Other bonds	9%	63	10%	70	12%	84	72	63	84
<b>Other investments</b>	<b>12%</b>	<b>84</b>	<b>12%</b>	<b>84</b>	<b>14%</b>	<b>98</b>	<b>89</b>	<b>84</b>	<b>98</b>
-Real estate	5%	35	4%	28	6%	42	35	28	42
-Alternatives	4%	28	3%	21	5%	35	28	21	35
-Unlisted infrastructure	2%	14	2%	14	2%	14	14	14	14
-Cash	1%	7	3%	21	1%	7	12	7	21
<b>Total</b>	<b>100%</b>	<b>700</b>	<b>100%</b>	<b>700</b>	<b>100%</b>	<b>700</b>	<b>700</b>		

Finally table 5 below compares the estimated PEPP related investments in different asset-classes with the current levels observed in the EU economy as of December 2015 (see also section E of *Annex 4*).

Table 6: PEPP related extra market-based funding and comparison to current values in the EU economy

Public capital markets	December 2015 (EUR Billion)	Corresponding PePP asset-class	Average		Lower bound		Upper bound	
			Increase (EUR Billion)	Increase (%)	Increase (EUR Billion)	Increase (%)	Increase (EUR Billion)	Increase (%)
Stocks	10,445	listed equity	198	1.9%	154	1.5%	238	2.3%
Bonds	23,775	debt securities	383	1.6%	322	1.4%	441	1.9%
Total public capital markets	34,220	listed equity & debt securities	581	1.7%	476	1.4%	679	2.0%
Users of funding (financial liabilities)	December 2015 (EUR Billion)	Corresponding PePP asset-class	Increase (EUR Billion)	Increase (%)	Increase (EUR Billion)	Increase (%)	Increase (EUR Billion)	Increase (%)
Non financial corporation - quotes shares	6,927	listed equity	198	2.9%	154	2.2%	238	3.4%
Non financial corporation - other equity	10,878	other equity and alternatives	58	0.5%	42	0.4%	77	0.7%
Non financial corporation - bonds	1,895	other bonds	72	3.8%	63	3.3%	84	4.4%
Governments	15,347	sovereign bonds	219	1.4%	140	0.9%	280	1.8%

The introduction of the PEPP is hence expected to provide to some extent a limited contribution to capital markets and to support non-financial corporations with their financing needs especially in the form of bonds and listed equity. The combination of the two is expected to contribute, albeit in a limited way, to jobs and growth (as explained in section 2.1 – underdeveloped capital markets).

Moreover, so as to further illustrate the order of magnitude, the estimated amount of EUR 14 billion in unlisted infrastructures potentially coming from PEPP (as reported in Table 6 under the average column) corresponds to around 5% the total amount of additional funding the European Fund for Strategic investments (EFSI) is expected to generate in infrastructures projects and SMEs. As for the estimated average amount of EUR 28 billion in alternative investments (as reported in Table 6 under the average

column), this also corresponds to 5% of the total market value of European private equity funds<sup>105</sup> with assets at EUR 564 billion in December 2015.

As mentioned, the analysis was carried out on the mid-point estimate of PEPP assets under management potential i.e. on EUR0.7 trillion and shows that the impact on CMU is positive although limited. The impact on CMU is expected to be lower for the minimum of the 95% confidence interval (where PEPP is expected to reach EUR0.4 trillion) or in case PEPP is at competitive disadvantage vis-à-vis national products when it comes to tax treatment (where PEPP superior features would not be able to compensate for no tax incentives and hence would result in a low take-up).

### **Demand side (other possible impacts on the capacity to better manage financial risk related to retirement)**

Whereas the previous section took the perspective of the total economy's balance sheet, the present section takes the view of financial risks of private households that need to be managed/hedged. From the perspective of the total economy, PEPPs benefits market-based funding channels (in contrast with bank-based intermediation of funds). From a household perspective, PEPPs facilitate a better diversification of assets.

The need for a broader set of risk management tools in the context of private pension liabilities has been widely acknowledged in the literature already before the crisis of 2007/8 and in international policy fora<sup>106</sup>. Ever since, as developments have heightened further the financial impact of demographic changes, there have been increasing calls for a more proactive risk management approach by governments towards risks faced by households, in particular related to retirement. This section briefly discusses how PEPPs compare as a risk management tool from a household perspective.

**The findings in the literature underline the relevance of the tax relief for private pension products to become attractive alternatives to more traditional savings methods.** This implies highly different relative weights of the various risks and impacts on savings discussed in table 4. Specifically, private pension products can only be expected to deliver effective protection against the four risk categories discussed there if significant amounts of savings have been allocated to such products. These amounts depend mostly on the extent of the tax relief. In terms of policy conclusions it follows that fiscal policy can ensure a better protection for households against financial risk in the context of retirement.

Table 7: How PEPPs compare to alternative savings methods in their capacity to help manage financial risk in the private pension context

RISKS/IMPACTS on savings	PEPPs compared to:						A: How PEPPs compare across alternative methods for a particular type of risk
	LIFE INSURANCE	DEPOSITS	BONDS	SHARES (listed or private)	Investment FUNDS (active or passive)	REAL ESTATE	
Loss of capital,	+/-	- (<100k)	- (PEPP without	++	+/-	++	+

<sup>105</sup> Private equity refers to the provision of equity capital to non-quoted companies with significant growth potential. Private equity funds invested in about 5 000 European firms in 2015, 86% of them being SMEs - statistics of Invest Europe are based on information of over 1 200 European private equity firms, representing 91% of capital under management in Europe

<sup>106</sup> On new instruments and methods see Groome et al. (2006), Draghi et al. (2004) and literature cited there, Gray et al. (2010), as well as Merton et al. (2013); see Visco (2005, 2006) on the policy discussion; complete references are listed in section C of Annex 4.

<b>risks w.r.t. economic or financial cycle<sup>107</sup></b>		+/- (>100k)	capital guarantee +/- (PEPP with capital guarantee)				
<b>Inflation<sup>108</sup></b>	+/-	++	+/- <sup>(1)</sup>	+/- <sup>(1)</sup>	+/-	+/-	+
<b>Lock In<sup>109</sup></b>	+	++	++	++	++	+/-	++
<b>Risks w.r.t. financial literacy &amp; product design<sup>110</sup></b>	+	--	+/-	+	+	-	+/-
<b>Tax relief<sup>111</sup></b>	+	++	++	+/-	++	+/-	++ <sup>(2)</sup>
<b>B: How PEPPs compare to any particular alternative method across risk categories</b>	+	++	+/-	+	+	+/-	+/>++

**Notes:** (1) This assessment assumes that PEPPs provide for risk sharing in at least two ways: (i) investment in equity is fully diversified with respect to country- and sector-idiosyncratic risks; (ii) a considerable share (between 45% and 65%) is invested in debt securities, in such a way that countries' specific risks are fully diversified; see also the numerical simulation in the previous section. (2) This assessment holds only if tax advantages granted to a PEPP are similar to those discussed in the literature.

The discussion, also reflecting findings in the relevant academic literature, is summarized in Table 7 and set out in more detail in section D of *Annex 4*.

Overall, a PEPP scores well against main alternative savings methods (column A). It also scores well against each single alternative across the different types of risk (row B at the bottom of the table). PEPPs on many accounts have superior risk hedging features compared to other financial assets, as well as compared to real estate which continues to be the favourite method of saving for retirement of European households. The real estate, however, also makes retiring households vulnerable to large swings in the value of real estate assets.

### Small and medium-sized enterprises

The initiative is expected to expand the range of providers, including not only insurance companies (currently the major players in personal pensions) but also investment firms and asset managers, as well as specialised pension funds. It would tap additional private savings to channel them to productive investments on capital markets, as indicated above. In addition, as investment rules would allow investments in various types of assets, many providers could provide – at least in part - additional sources of finance to SMEs, who represent the bulk of the number of companies and value added in the EU<sup>112</sup>.

Furthermore, providers such as asset managers are often SMEs. As a consequence of this initiative, they could be positively impacted as this new business would open for them.

<sup>107</sup> Kaliciak et al. (2016); Gompers/Metrick (2001); Reinhart/Rogoff (2009).

<sup>108</sup> Feldstein (1981) discusses private pension performance with respect to inflation risk

<sup>109</sup> Sexauer/Spiegel (2013)

<sup>110</sup> On financial literacy see Lusardi/Mitchell (2014) for a comprehensive overview; Cochrane (2013) on product design; Varian (2010) on online distribution

<sup>111</sup> Feldstein (1981) discusses the importance of tax relief for the relative performance (RoI) of private pension funds

<sup>112</sup> Source: European Commission, 2016 SME Performance Review, Annual Report: "Across the EU28, the contribution of SMEs in the non-financial business sector is considerable. SMEs make up 99.8% of all enterprises, 57.4% of value added, and 66.8 % of employment." Available at: [http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review-2016\\_en](http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review-2016_en).

Also, a positive effect can be expected for the self-employed who do not contribute in such capacity to a state-based or occupational pension.

### **Administrative burden**

As the PEPP is a new product category added to the existing portfolio of products provided by insurers, pension funds, investment firms, asset managers and banks, all subject to regulatory oversight by national competent authorities under existing regulatory frameworks, this could create an additional administrative burden. The administrative burden would depend on the supervision of PEPP providers at national level. Public authorities might impose new reporting requirements on providers as regards the provision of PEPP and in particular to monitor cross-border distribution of PEPPs. This administrative burden should be proportionate to the risks of providing PEPPs on a cross-border basis and would allow market monitoring ensuring appropriate supervision and contributing to consumer protection. To this end, the PEPP framework could include some principles on reporting to supervisory authorities.

### **EU budget**

The preferred policy options could have some implications for the budget of the European Union. Possible additional tasks arising for EIOPA or ESMA in particular, such as the authorisation of PEPP products, the development of additional guidance or and a central register for all authorised PEPPs, would require an increase in resources as well as certain operational investments. These costs are estimated at approximately EUR 1.000.000 in 2019 and include a one-time investment for operational matters and will stabilise around EUR 1.200.000 by 2021. Under the current co-financing arrangements, 40% of this funding will be included in the EU budget and will, as such, not go beyond what is foreseen in the current multi-annual financial framework running until 2020.

### **Social impacts**

This initiative on pan-European personal pensions would have potentially positive social externalities insofar as it could improve the take-up of personal pension products. An increase of take-up of personal pensions over time would have as a positive side effect that it would increase the portion of the population with adequate income in retirement. In particular, it would provide additional tools to the self-employed and mobile workers save for retirement by means of personal pension products. The positive social impact would be higher in Member States where currently there is a limited choice and limited take-up of personal pension products.

### **Impact on third countries**

The proposal does not create any new obligations concerning the relations with third countries. Consequently, no impact on third countries is expected.

### **Environmental impacts**

No significant environmental impact is expected, although an encouragement for providers to voluntarily take into account environmental, social and governance factors for their investments (associated with disclosure requirements) could have a positive environmental effect.

## 6. MONITORING AND EVALUATION

The proposed rules should include a review after three years of application of the statute, with a particular focus on its appropriateness and effectiveness in meeting the original objectives.

After the entry into force of the Regulation, Commission will monitor the implementation through its regular infringement process as well as through its regular contacts with stakeholders (e.g. consumers, industry and/or ESA's).

As part of the review, **key performance indicators (KPI)** of impact of the measure will be:

***KPI's to monitor the objective to increase investment in the EU and contribute to completing the CMU:***

**KPI 1: Total uptake (in terms of Assets under Management) of PPPs (including national PPPs and the PEPP, compared to the baseline scenario.**

The total uptake in terms of assets under management of all PPPs including national PPPs and the PEPP is a measure for success as the PEPP will set out the benchmark in terms of product features. Due to competition forces, national PPPs could take over PEPP features, driving take-up. Success can be measured in case the trend in total uptake would be statistically higher than the uptake of the baseline scenario (encompassing national PPPs). This information is available through the household statistics survey of EUROSTAT to be combined with information by EIOPA.

**KPI 2: Geographical and sectoral distribution of PEPP providers and investments in PEPPs**

A broad geographical spectrum of PEPPs' take-up would prove their popularity regardless the relative wealth of households in different Member States and provide evidence of the contribution to a CMU. A broad circle of PEPP providers from different sectors of the financial industry would testify for the economic viability of PEPPs and increasing inter-sectoral competition and would provide evidence of the creation of a true single market for personal pensions as part of the CMU.

***KPI's to monitor the enhancement of product features on the personal pension market***

**KPI 3: Number of PEPP registrations as taken from the central register kept by EIOPA.**

The number of applications after introduction of the PEPP provides important information on the availability and market adoption of features entailed in the PEPP.

**KPI 4 : Relative share of PPPs (including national PPPs and PEPPs) compared to household financial assets.**

A statistical increase in the relative share (compared to the baseline scenario) would imply that households, after introduction of PEPP, have a higher share of savings in PPPs as compared to holdings of other financial assets such as e.g. savings in deposits. This

statistic is available following the household statistics survey of EUROSTAT to be combined with information by EIOPA.

***KPI's to monitor the cross border provision and portability of PPPs:***

**KPI 5: Number of providers using a passport over a period of 5 years (cross border activity by providers either through free provision of services or freedom of establishment)**

A positive trend in the number of providers using a passport is an indicator of increased cross border activity of providers. This data should be available through competent authorities & ESAs.

**KPI 6: Relative share (in numbers and in value of assets under management) of PEPPs with more than one (national) compartment compared to all PPPs (including national PPPs and PEPPs) (measure of cross border activity by individuals).**

A positive trend of the share of PEPPs with more than one compartment is an indicator that individuals are participating in the PEPP in a cross border context. This data should be available through competent authorities & ESAs.

Finally, the review should assess to which extent the potential Commission recommendation for a preferential tax treatment for the PEPP has been taken up by Member States through national legislation.

The data collected by EIOPA and ESMA in particular could contribute to monitoring the PEPP's indicators in terms of take-up, increased investments in the CMU context and increase in cross-border provision.

## ANNEX 1 – PROCEDURAL STEPS CONCERNING THE PROCESS TO PREPARE THE IMPACT ASSESSMENT REPORT AND THE RELATED INITIATIVE

- Lead Directorate-General: Directorate-General for Financial Stability, Financial Services and Capital Markets Union.
- The initiative is included in the Commission Work Programme 2017 item: 2017/FISMA/001
- Organisation and timing of Inter Service Steering Group's meetings: three meetings on 24 November 2016, 2 February and TBD March 2017. The Inter Service Steering Group included representatives of the Directorates General, Competition (COMP), Economic and Financial Affairs (ECFIN), Employment (EMPL), Internal Market, Industry, Entrepreneurship and SMEs (GROW), Justice and Consumers (JUST), Taxation and Customs Union (TAXUD), Trade (TRADE), the Legal Service (LS) and the Secretariat General (SG).
- Evidence used in the impact assessment:
  - Replies by stakeholders to the following public consultations:
    - From 28 July until 31 October 2016: a public consultation on personal pensions to obtain feedback from stakeholders on a potential European framework on personal pensions, [http://ec.europa.eu/finance/consultations/2016/personal-pension-framework/index\\_en.htm](http://ec.europa.eu/finance/consultations/2016/personal-pension-framework/index_en.htm)
    - From 30 September 2015 to 31 January 2016: a public consultation in the framework of the Call for Evidence on the EU regulatory framework for financial services inviting feedback and empirical evidence on the benefits, unintended effects, consistency and coherence of the financial legislation, [http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index\\_en.htm](http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm)
  - A public hearing on personal pensions: towards a pan-European pension product? held on 24 October 2016: [http://ec.europa.eu/finance/events/2016/1024-personal-pension-framework/index\\_en.htm](http://ec.europa.eu/finance/events/2016/1024-personal-pension-framework/index_en.htm)
  - A public hearing on the Call for evidence, held on 17 May 2016: [http://ec.europa.eu/finance/events/2016/0517-call-for-evidence/index\\_en.htm](http://ec.europa.eu/finance/events/2016/0517-call-for-evidence/index_en.htm)
  - Advice from the European Insurance and Occupational Pensions Authority (EIOPA) on the development of an EU single market for personal pensions: <https://eiopa.europa.eu/Publications/Consultations/EIOPA%27s%20advice%20on%20the%20development%20of%20an%20EU%20single%20market%20for%20personal%20pension%20products.pdf>
  - Discussions with experts from Member States' authorities on 18 October 2016 (Expert Group on Banking, Payments and Insurance (Insurance Formation))
  - Statistics and reports on Pensions published by the OECD.

## ANNEX 2 – STAKEHOLDER CONSULTATIONS

### 1. SYNOPSIS OF CONSULTATIVE WORK

To develop the impact assessment, different types of consultative work have been undertaken, in particular by EIOPA to design its technical advice and by the European Commission. Furthermore, as part of the EPPF study, Ernst & Young conducted a workshop with all relevant stakeholders. In addition, an Expert Group meeting was held with representatives from Member State to discuss the aspects of direct taxation.

A synopsis of the consultative work can be found below:

#### **EIOPA Technical Advice**

The EIOPA technical advice has been developed in a number of consecutive steps.

First of all, the advice builds on EIOPA's 2014 preliminary report "Towards an EU-Single Market for personal pensions".

Second, as part of the EIOPA technical advice, two consecutive consultations have been undertaken by EIOPA:

- 1) EIOPA's 2015 consultation paper on the creation of a standardised Pan-European Personal Pension product (PEPP) and;
- 2) EIOPA's 2016 consultation paper on EIOPA's advice on the development of an EU Single Market for PPP3

The public consultations were carried out from 7 July to 5 October 2015 and the second one from 1 February to 26 April 2016 and were addressed to all interested parties. Most responses came from the insurance and asset management industry; important feedback was received from a smaller number of consumer representatives.

The main results from the consultation were that most stakeholders supported the introduction of a voluntary standardised Pan-European Pension Product via a 2nd regime. Stakeholders were optimistic that at least in some Member States there would be demand for diversifying the sources of future retirement income, and in particular where there is pressure on state pensions and underdeveloped occupational pensions. Stakeholders agreed that standardisation would make personal pension products more attractive to both PEPP savers and providers and enable cross-border activities. Many stakeholders stressed that the main barrier to cross-border activities- taxation - cannot be resolved at European level.

#### **European Commission Public consultation on personal pensions – July-October 2016**

As part of the Capital Markets Union (CMU) Action Plan, the Commission announced that it would assess the case for a policy framework to establish European personal pensions. More investment into personal pensions contributes to a stronger single market for capital through an increase in the funds available to finance the economy.

The objective of the public consultation was to identify potential obstacles to the take-up of personal pension products and to seek views on how to best address them. The consultation will also help the Commission analyse the case for an EU personal pension framework. To that end, individuals (citizens, pensioners, students) and other stakeholders (companies, representative associations, governments) are asked their opinion on possible EU action in order to offer personal pensions to individuals which are simple, affordable, transparent and provide better returns.

The public consultation ran from 28 July 2016 until 31st of October 2016. Overall, 595 responses were received, of which 485 from savers, 10 from consumer organisations and 80 from professional stakeholders. Across all stakeholders, there was consensus on the need to complement public and occupational pensions with personal pensions. Retail investors were supportive to the idea of simple transparent personal pension products and consider purchasing if available. Consumer organisations pointed to the low quality of existing PPPs. In particular they pointed to the overall insufficient transparency of costs and fees of PPPs. Providers indicated that from the proposed options for a European Personal Pension Framework, a Pan European Personal Pension Product has the highest potential to achieve objectives. A pension account and code of conduct are a considered a second best option at equal footing. The least favoured option by professional respondents was harmonisation of existing legislation on PPPs.

**A detailed summary of the public consultation can be found below**

#### **Public hearing – 24 October 2016**

On 24th of October 2016, the Commission organised a public hearing gathering all stakeholders including savers, consumer associations, banks, insurers, pension funds and asset managers. The goal was to take stock of the views of stakeholders on the creation of a European Framework for personal pension products. The conference was attended by approximately 250 stakeholders.

#### **Meeting with expert group on direct taxation – Working Party IV Direct Taxation – 2 March 2017**

The exchange of views with Member States' tax experts on a Pan European Personal Pension Product showed an interest from some Member States in an initiative on personal pensions. In particular, Member States welcomed the voluntary nature of the possible product in addition to already existing personal pension regimes. All Member States that intervened favoured the semi-flexible or fully-flexible approach for a PEPP. Flexibility is favoured by Member States as this would allow applying to the PEPP the same features as for their existing PPPs in order to qualify for direct tax incentives. All Member States that intervened made clear that they would only consider granting a favourable tax treatment to the PEPP if product features would match their national criteria for tax incentives. A few Member States invited the Commission to thoroughly explore subsidiarity and proportionality for this proposal. The feedback received during the working party was taken into account for this impact assessment.

#### **EY feasibility workshop on personal pensions - 15 February 2017**

As part of the EPPF study, Ernst & Young organised on 15 of February 2017 a workshop with 30 experts from all stakeholder groups including savers, consumer associations, banks, insurers, pension funds and asset managers. The goal was to have an in-depth

discussion on the key features of a possible personal pension product in particular the impact on stakeholders. In particular, the workshop discussed alternative approaches for the key features of a European Personal Pension Product. The topics discussed were possible limitations of investment options for savers, the applicable rules for distribution of the European Personal Pension Product, the out-payment options available on retirement, the appropriate disclosure requirements, authorisation and supervision of providers.

The feedback received during the workshop was used for the feasibility assessment in the EPPF Study.

## **2. DESCRIPTION OF THE PUBLIC CONSULTATION ON PERSONAL PENSIONS (JULY-OCTOBER 2016)**

### **2.1 The consultation mechanism**

The Commission's consultation on a potential EU personal pension framework<sup>113</sup> was launched on 28 July 2016 and closed on 31 October 2016. It collected views on how to best address the current obstacles within the personal pensions market and helped to assess the feasibility of a potential EU policy framework to establish a successful European market for simple, efficient and competitive personal pensions.

In particular, the consultation was designed to help the Commission map individuals' and providers' expectations for an EU personal pension framework. The consultation gathered views on how, in the future, personal pensions can better complement retirement income and how to make individuals more confident about using personal pensions to save for their retirement.

This Annex offers a brief overview of the input received through the public consultation on the case for an EU personal pension framework. The Commission's minimum standards for public consultations were all met. Within the online questionnaire, three separate sets of questions were developed for three target groups:

- private individuals (*part B1*) – they were invited to provide information on their experience using personal pension schemes and whether they are interested in using these schemes to save for their retirement;
- consumer organisations (*part B2*) – expected to share their views on consumer experiences and preferences linked to the interest in saving for retirement, products' assessment, expectation of simple, affordable efficient and safe personal pensions with good returns, as well as consumers' preferences with regard to the information available when investing in personal pensions;
- other stakeholders in professional capacity: those who provide, would provide, or represent organisations that are or would be involved in providing personal pensions, public authorities regulating personal pensions, academics or other professionals involved with personal pensions in a professional capacity (*part B3*). Thus, the consultation probed the views of professionals working in the

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<sup>113</sup> [http://ec.europa.eu/finance/consultations/2016/personal-pension-framework/index\\_en.htm](http://ec.europa.eu/finance/consultations/2016/personal-pension-framework/index_en.htm)

pensions industry and their interest in offering simple, affordable and transparent personal pension products which work towards providing better returns.

These three broad target groups were designed to include all citizens and stakeholders, EU Member States, national, regional and local authorities, intergovernmental and non-governmental organizations, researchers with an interest in pension issues, trade unions, civil society organizations and other organisations or individuals.

The public consultation was undertaken in the form of an e-survey. An online questionnaire was available, with the three sets of questions covering practically all important aspects of the action discussed and tailored to match the level of knowledge, experience and sophistication of each respondent target group. An additional incentive for stakeholders to participate was the potential of the consultation to enable the Commission to assess what can be done at EU level to support a wider choice of personal pensions competing across borders.

The received responses were published on the Internet.

## **2.2. Summary of responses to the consultation**

Overall 585 responses were received by following stakeholder groups:

- 494 private individuals;
- 11 consumer organizations;
- 80 respondents acting in professional capacity.

The below summary is more elaborate regarding professional stakeholders compared with private individuals and consumer organisations due to the more detailed questionnaire for professional stakeholders.

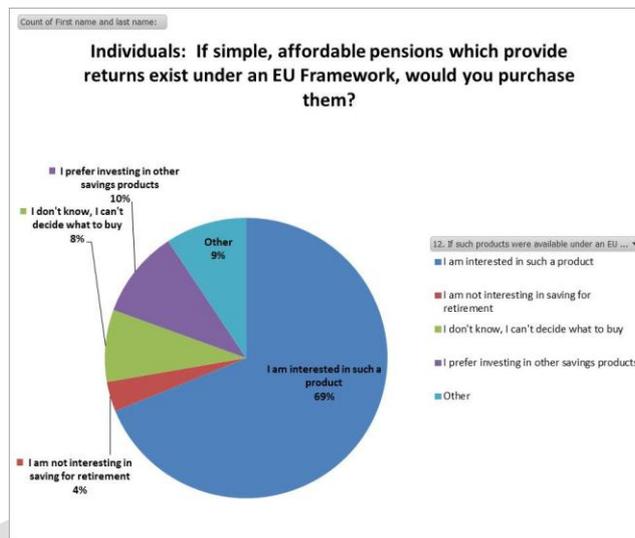
### **2.2.1. Summary of views of private individuals**

In general, a large majority of respondent private individuals agree there is a need to complement public and occupational pensions with private pensions. Only a small minority consider that the current public and occupational pension provision would be sufficient.

Private individuals not investing in a personal pension indicated a wide range of distinct reasons explaining their behaviour. Few consumers indicated they count on state-based and occupational pension. Some respondents refer to the lack of awareness of existing pension savings products. Some others refer to drawbacks such as the insufficient portability, or to high fees. A few respondents considered that the tax incentives were not sufficient. In addition, some refer to the lack of available funds for any personal pension savings, while others invest in other types of financial instruments/products. Only a minority of respondents consider that the PPPs currently available are simple and transparent.

A large majority of respondents is interested in a European Personal Pension product if it would be available. A minority would consider investing in other savings products or does not know what to choose. If asked on how individuals would purchase the pension product, respondents favoured a wide range of distribution channels including online distribution. A significant minority of respondents considered purchasing online even if no advice would be offered. Most respondents consider product information important. Information considered important includes information on investment options available and information on past returns of the product. In addition, information on annual fees

and returns, information on tax relief, information on the level of protection provided on the savings is considered important by a majority of individuals. Respondents also considered important information on flexibility of contributions and the possibility to allow for temporary interruptions of the contributions in specific situations (e.g. unemployment) while preserving the acquired rights. A majority of individuals considered such product information should be available before signing up to the product and updated periodically during the lifetime of the product. Respondents also considered it important that information should be available by means of a standardised information sheet.



### 2.2.2. Summary of views of consumer organisations

In general, a majority of consumer organisations agree there is a need to complement public and occupational pension. Furthermore, consumer organisations indicate that a large majority of consumers is not satisfied with the existing personal pension products available to consumers. A majority of consumer organisations are of the view that consumers are not adequately informed of the fees and charges they pay on and the returns they get from personal pension products. One consumer organisation considered that consumers are provided with information on fees and returns, but this information is sometimes presented in an opaque way. Another consumer organisation considered that fees are not disclosed in an aggregate way, especially in case of multi-layer products such as unit-linked life insurance. As a consequence, pension savers do not know the full fees and commissions, because they are not disclosed. The information provided on returns is also often incomplete and does not indicate the net return, after taxes and applicable fees.

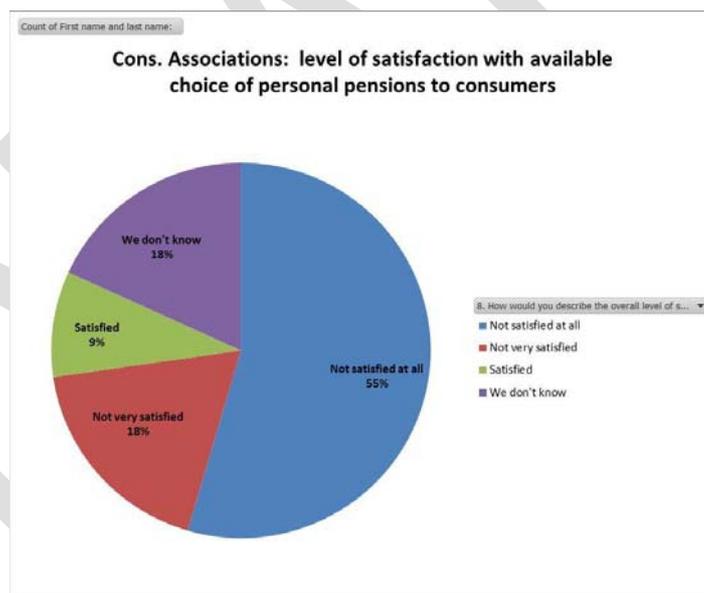
As regards the features of the product, consumer organisations underline the importance of consumer protection, as personal pensions are long-term savings products requiring contributions over a very long period of time, often three or even more decades. This underlines the importance of protecting savings, ensuring appropriate disclosure of information on investment options and on the possibility of switching. To ensure product simplicity, a majority of consumer associations generally support the concept of a simple and safe default investment option combined with a limited number of alternative investment options.

Consumer organisations favour protection of savings by risk-mitigating techniques. A limited number of consumer organisations favour a guarantee on capital or a guarantee

on returns as the right approach to protect savings. Some consider that a guarantee on nominal capital could be misleading and detrimental to EU pension savers due to inflation. One consumer organisation considered that personal pension products with guarantees in the accumulation phase are often a bad deal for savers, because of the associated costs and product complexity. However, some consumer organisations considered that for some savers (e.g. those closer to the retirement age) guarantees could still be interesting, but in those cases there should at least be inflation-proofing. One consumer organisation considered that a default investment option with a capital-backed guarantee could reassure individuals who are not familiar with finance and unwilling to bear any financial risk over the entire accumulation period and who want to be certain as to the minimum return their pension product would provide.

Furthermore, switching should be without conditions in the view of consumer organisations. However, one consumer organisation considers that too flexible switching could entail risks of miss-selling in case of consumers with low level of financial education.

For decumulation, consumer associations support flexibility for savers in the options. In addition, consumer organisations find cross-border portability important, also in the decumulation period.



### 2.2.3. Summary of views of professional stakeholders

#### *Challenges*

It is instructive that most of the professional stakeholders responding to the questionnaire (Part B3) do not offer personal pension products to consumers, and almost half of those who do have such activity do so in only one EU Member State. Mostly **tax issues** are mentioned by respondents from virtually all fields of activity and sectors as limiting the development of personal pensions in the relevant Member State(s) of activity. The absence of a specific tax treatment for individuals to save/postpone income for a longer term is decried. **Complexity** (sometimes even regulatory contradictions) is pointed out

mainly by trade unions and non-governmental organisations as another problem, national prudential rules and administrative requirements constituting one of the main obstacles to the development of personal pensions by smaller companies. **Differences in national legislation**, such as administrative rules, contract law, taxation, social security law and supervision are important barriers which limit the development of personal pensions. As one insurance industry association points out, some PPPs are governed by Solvency II capital requirements, which it says are not adapted to the risk management of the retirement business. **High costs** of obligatory public pension schemes also contribute to limit availability of savings for personal pensions. Citizens are obliged to contribute up to 25% of their income to public schemes. According to both companies and think tanks, the relatively low penetration of PPPs in some Member States has less to do with the product supply, but more with **low awareness** about pensions among citizens and insufficient financial education. As insurers explain, in some Member States the **replacement ratios from state pensions** are still at a high level. Given the current economic situation, the unemployment rate, stagnating wage levels, a serious obstacle is represented by **low income** of workers across Europe, which is a natural concern for the participating trade unions.

As issues which limit the development of personal pensions across borders insurers, pension funds and asset managers almost unanimously point out the **varying national requirements and tax regimes** from one Member State to the other. Consensus exists that **insufficient demand from individuals for cross-border pensions** (e.g. due to uncertainties about cross-border providers, perception that a cross-border pension would only be relevant in case of mobility, etc.) represents a major obstacle.

### ***Key Features of a PEPP***

#### ***Distribution, including information and advice***

As regards **distribution**, the **distribution channel** mostly favoured by professional stakeholders (whatever their sector) in order to maximise the benefits and efficiency gains of a Single Market for personal pensions is the online channel. A large insurance company is of the view that a mix of face-to-face and online access is the best solution: in addition to the promotion of the product, for most investors oral explanation and answers to questions would be needed for distribution. It is opined, by insurance industry associations and asset managers, that distribution via commercial banks would hinder creative disruption as would do all kind of kick-back mechanisms with intermediaries, but others (mostly institutional investors) underline their preference for distributions through banks, insurers or direct distributions to their clients, depending the profile of their client. Most stakeholders believe that all distribution channels should be possible for convenience and freedom of choice. Legislation should not hinder nor incentivise one channel over another. Online sales should be subject to the same transparency requirements as “traditional” distribution channels to avoid distorting competition, the regulation being technologically natural. It is also pointed out (by an insurance company) that there is a need to cater for the advantages of promoting / distributing through the workplace, as well as the ability to use mechanisms like automatic enrolment into schemes to encourage greater take up.

When asked whether they consider that there should be **mandatory advice** for the provision of personal pensions, the greater part of business representatives reply that pensions products are normally long-term products that require individual advice, regardless of distributed on provisions or fees. However, there are views (mainly from think tanks and smaller companies) that advisory services should not be mandatory and

should be linked to the complexity and costs of the PPP, taking into account the situation of every member.

On the question what **information** is most relevant to individual savers **before signing up to a product**, the respondents from all business fields almost unanimously consider the information on the tax regime for contributions, returns and pay-outs as very important. The information on the provided level of protection is also assessed as being such. The opinions are more divided (between the assessments "very important" and "fairly important") on the information about available investment options, different types of fees and level of fees disclosed annually. Less importance seems to be assigned by the professional stakeholders to the information on the rate of return over the last two years and on information provided in a standardised format (similarly to the PRIIPs KID).

Replies are mostly negative with regard to the question whether the **PRIIPs Key Information Document** (KID) or some elements of it should be used for the purposes of personal pension disclosures. The overwhelming majority of respondents across the different fields of activity are convinced, however, that PRIIPs constraints are too high to allow a wide distribution of pension products.

When asked is there any other information that would be of importance for savers before signing up to a product, professional stakeholders (from the insurance sector) mention, for example:

- Information about guarantees;
- Understandable performance scenarios for the target benefit level, indicating also that the performance of the product is not certain;
- Different possibilities for the pay-out phase;
- Coverage against biometric risk, e. g protection against longevity risk, protection of surviving dependents;
- Focus on the possible maximum loss of invested capital at retirement, also whether the consumer can lose all invested capital.  
The total cost impact of fees (RIY).
- minimum investment period(s);
- degree of illiquidity and conditions for partial withdrawal (e.g. medical expenses) depending on national law;
- risk coverage where provided (e.g. death/life/disability);
- consequences of early termination.
- environmental and social investment policy
- information on the portability of the product in the event of moving to another Member State and exit rules.

When asked what **information** is most relevant to individual savers **during the lifetime of the product**, professional stakeholders are almost unanimous (whatever their business field) that the information on accumulated benefits, the level of fees and on the tax treatment of savings is of utmost importance, although the other types of information (current and available investment options, the rate of return, the level of protection provided and the expected benefits at retirement) are also assessed as being of certain significance.

### ***Investment policy***

The predominant view among insurers and their associations is that there should be a **default investment option** in a personal pension product which would provide simplicity and safety catering for the needs of a majority of personal pension savers. As a type of protection attached to the default investment option (ensuring simplicity and safety for investors in personal pensions), protection of capital and on returns are mentioned (this choice to be left to the consumer), although some respondents, mostly asset managers, believe that no capital protection is needed: any mandatory guarantees of value of assets is perceived as not desirable, since it decreases the return. Yet another view, mainly maintained by some think tanks, is that guarantees can be optional.

On the question whether the number of **alternative investment options** should be limited the opinions are almost equally split. The supporters of such a solution, engaged e.g. in supervisory and regulatory activity, argue that too many options cause confusion to members and that might lead them in the direction of not taking the best decisions for their own interest. A consultancy firm sees no compelling reason for this to be set at the European level. One major company involved in investment management considers that life-cycling with de-risking strategy may provide sufficient protection to investors. In the present context of low interest rates (which may be lasting) any guarantee would be costly with detrimental effects on the final return. In addition, investment in a PEPP would be spread over a long period, which limits risks linked to financial markets' variations. Others (e.g. those involved in investment management or think tanks) favour a limited number of investment options, but without imposing a fixed number. While providers should avoid the potential for choice overload, it would be beneficial for them to be given flexibility in deciding the number of options to offer. Providers of PPPs should be given sufficient freedom to determine the available investment options of their product, however this issue has to be complemented with the care of consumers. A sufficient number of alternative investment options may represent a suitable option to help consumers in their choice. Some insurers oppose product restrictions at the EU level, as this could limit providers' freedom to design products and hamper innovation, thus limiting consumers' choice and ability to access products tailored to their needs.

### ***Portability***

On the question should a **personal pension product be portable** across Member States, all professional stakeholders consider that it is either very or fairly important. When asked what the **main barriers for portability** of existing personal pension products are, companies consider that the main barriers are varying regulation and taxation. Disparity of regulation may be trickier when it affects the structure of the PEPP itself, the reason why a 2<sup>nd</sup> regime could allow for overcoming regulatory barriers.

Another barrier mentioned is the insufficient information provided. In this field, compulsory information on future pension estimation could also provide the opportunity to provide information on PEPP. According to the classification of an industry association, the main barriers are: i) differences in the regulation of pension contributions and in tax rules; ii) language and informational barriers, whereby a citizen moving to another Member State may find it difficult to look for information documents on personal pension products in the destination country, especially if these documents are available only in a language he/she is not familiar with. Similarly, for financial advisors operating in the destination country, these barriers may hinder their capability of assisting European citizens moving from one Member State to another; iii) exit costs for personal pension products.

Other stakeholders (coming e.g. from the academic world) believe that portability is not always compatible with the nature of the pension product, for technical reasons, which should be taken into account before assigning any general objective. Some stakeholders advise to preserve supplementary pension rights for PEPPs as it is done for workers in the Directive 2014/50/UE and in the same time, support at European level a disclosure system for citizens about their pension's level in different pillars.

### ***Provider Switching***

Asked under what conditions it should be possible to **switch personal pension providers**, the majority of professional stakeholders, mainly industry associations of insurers and pension funds, believe that switching should be only possible after a minimum lifetime of the product and allowed only a limited number of times. Cost and fees should be left to competition between providers. Protection against biometric risks might be diminished or lost by switching providers. The insurance collective could be weakened if switching were allowed without charges and at all times. Less are those – mostly trade unions and think tanks – considering that switching should be possible without conditions. They usually declare full support for consumer mobility and freedom for savers to consolidate their savings. Nevertheless, providers should have the freedom to apply a charge for switching when consumers regularly switch. A large company (involved in insurance, pension provision and investment management) observes that, across borders, when a customer has become resident in another Member State but wishes to switch an existing product in the home Member State to another product/provider, the applicable general good rules of the host Member State create legal risks for the provider. An extension of the insurance contract freedoms would reduce this risk.

### ***Decumulation***

As to the preferences to **forms of pay-out**, the majority holds that there should be flexibility in the decumulation phase, because due to different consumer expectations across the EU, different decumulation options should be possible. As one company concludes, irrespective of the form of pay-out offered, it is extremely important to keep communicating and engaging with customers throughout the decumulation phase to ensure they do not take decisions that negatively impact their retirement income in the long run.

Those preferring life time annuities (mostly trade unions, as well as some professional associations and non-governmental organizations) provide arguments that a PPP can only contribute to secure income in retirement if consumers are protected from exhausting their assets before they pass away. Moreover, as declared by some insurers and their associations, sharing biometric and financial risk during the pay-out phase (within insurance collective and over time) increases predictability and stability of retirement income streams for consumers.

Asked about the factors which would **encourage competition** to offer high quality, affordable personal pension products, professional stakeholders (mostly from the insurance industry and the few responding banks) agree that very important are the transparency on fees and costs, the level of fees and returns, as well as tax and other financial incentives to personal pension savings. Less importance is accorded to the type of investment policy (active versus passive), to the ease of distribution, as well as to the existence of a benchmark to assess the product's performance, safety and simplicity. The

consumer awareness of the availability of retirement products is assessed as fairly important too, especially by investment firms and their collective bodies.

### ***Tax treatment***

There is consensus that **tax incentives** are important for the uptake of personal pension products by savers. The fiscal benefits are deemed very important virtually by all types of organizations and sectors. The market seems to organize itself also around tax benefits.

According to an association of specialized financial institutions (building societies), not only tax deductibility, but also subsidies are important ways to promote private retirement provision. Both incentives are needed to achieve a preferably high level of participation at “private pension prevention in the societies”.

Providers offering personal pension products in other Member States were asked how they **accommodate differing national tax regimes**. It is instructive that most of the responding professional stakeholders actually do **not** provide PPPs outside their Member State of establishment. Those few who do this operate mostly through branches or subsidiaries. Only three (in the fields of investment management and occupational pensions) declare that they operate directly across the border without branches or subsidiaries.

### **Possible EU Action**

On the question what are the most significant **benefits of providing personal pensions on an EU scale**, most professional stakeholders, companies, SMEs and/or other institutions involved in the management of funds deem as very important the lower operating costs and making the PPP attractive to mobile customers.

On fostering **cooperation** between stakeholders (Member States, providers, consumers) around a common approach to providing personal pension products, most stakeholders from all business areas respond that such an approach would not address at all, or would address only partly, the challenges of:

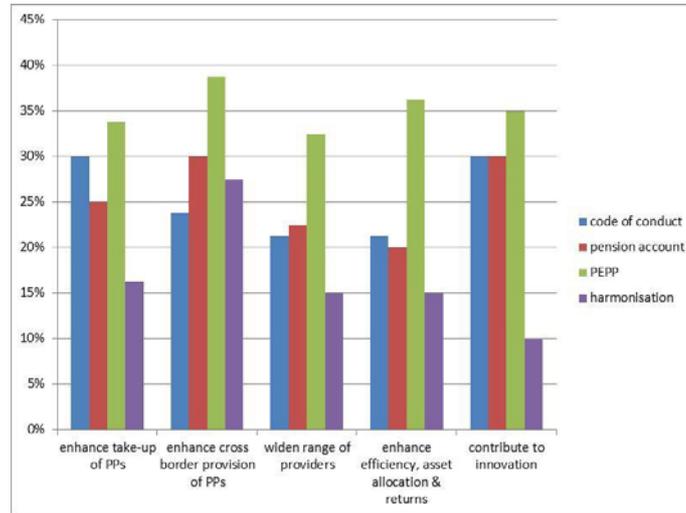
- enhancing the take-up of personal pensions by consumers in the EU;
- cross-border offering of personal pension products by providers in the EU;
- widening of the range of providers;
- enhancing efficiency, asset allocation and returns;
- contributing to innovation within the PPP market.

On establishing a **European personal pension account**, similarly to the Individual Retirement Account (IRA) offered in the United States, the stakeholders' opinions are split. The greater part (insurers, asset managers) respond that such an approach would not solve at all, or would solve only partly, the above-mentioned challenges, but there are some views (mostly from banks and trade unions) that IRA could largely contribute to address these challenges.

On establishing a **European personal pension product** on a voluntary basis, based on a set of common and flexible features, most professional stakeholders assume that this solution would largely and even decisively address the above-mentioned challenges. A shade of scepticism characterizes those opinions (not an insignificant number, coming mainly from some industry associations in the field of investment management) according to which the challenges would be only partly addressed by this solution.

The attitude of professional stakeholders on the option of **harmonizing national personal pension regimes**, but excluding tax requirements are viewed as not attractive. Most respondents, across all sectors and fields of activity, consider that such a solution would partly address the above-mentioned challenges, or would not address them at all.

**Professional Capacity: industry views on the attractiveness of policy options**



## **ANNEX 3 – WHO IS AFFECTED BY THE INITIATIVE AND HOW**

**The main stakeholder groups affected by this initiative are the following:**

### **Individuals**

The product would provide additional choice for all EU individuals saving for retirement. They would benefit from a new simple, transparent personal pension product and potentially benefit from increased competition, lower costs and potentially higher returns.

The new product would facilitate saving for retirement by self-employed who do not contribute in such capacity to an occupational pension.

As regards the cross-border dimension, the new product would be particularly attractive for mobile workers (currently, 11 million persons in the EU).

### **Providers including insurers, pension funds, asset managers**

Insurers, pension funds and asset managers and banks would be enabled to provide the personal pension product to the market and facilitate cross-border provision of personal pension products.

Insurers, which are in the majority of cases the incumbent national providers of existing PPPs, would be enabled to provide the new European personal pension product in addition to existing national products. They would likely face additional competition from asset managers and pension funds which are enabled to provide personal pension products under the EU rules.

All providers would be facilitated to create economies of scale through increased standardisation of product features and would compete on the basis of a level playing field.

### **Public authorities**

Public authorities would ensure the supervision of the personal pension product to ensuring compliance of providers with product features set out in the EU rule. This should ensure that providers compete on the basis of a level playing field and that the savers are sufficiently protected. Competent authorities will ensure supervision of regulated entities. Authorisation of the PEPP and compliance with product requirements could be attributed to one of the European Supervisory Authorities.

## ANNEX 4 – ANALYTICAL MODELS USED IN PREPARING THE IMPACT ASSESSMENT

### Section A - Assets under management under the baseline and PEPP scenarios

As mentioned in the body of the impact assessment, the current PPP market is estimated at EUR0.58 trillion euros as of 2014 on 24 Member States where the contractor managed to collect meaningful data. In order to have an estimate for the whole EU as a starting point of the projection of the baseline scenario (i.e. without the introduction of the PEPP), the AUM for the missing member states is based on these countries' shares in total households financial assets excluding currency and deposits which is calculated at 26% as per Eurostat data<sup>114</sup>. By applying this correcting factor, the current market is then estimated at EUR0.72 trillion euros.

In the absence of the PEPP, the personal national markets are expected to grow to EUR1.4 trillion euros by 2030 given the growth of underlying assets and new investments (e.g. premiums) by current and future PPP holders. This estimate projects PPPs to grow in line with previous growth of total financial assets of private households as observed for all 28 member states between 2012 and 2016 (this is the longest time span where data is available for all EU member states).

As for the scenario including a successful take-up of the PEPP, one could reasonably expect that the first products will be sold within two years from the date of application of the PEPP framework. As also explained in the above, this takes into account the legislative process, the possible technical standards developed after the entry into force of the regulation and the time needed for providers for the design, the marketing and the distribution of the product. If successful, the PEPP can reach its full market potential - EUR0.7 trillion – over a 10-year period taken into account the PEPP would receive favourable tax treatment in all Member States. Without the favourable tax treatment the uptake would take longer and would be closer to the baseline scenario. Details about the PEPP market potential modelling could be found in section B of this Annex.

### Section B – PEPP market potential modelling

The PEPP market potential has been estimated in three steps which are explained below.

#### **Step 1 – the penetration index**

A penetration index was built to identify the most successful PPPs. This measure of success is a multidimensional indicator taking into account three dimensions:

- The product's level of capitalization: the level of product asset under management (AuM) compared to households financial assets (HHFA) was used to measure product's success in terms of capitalization or asset accumulation. The household financial assets were preferred to the more common GDP, because however similar (see figure below), HHFA is a closer proxy to measure the ability to invest in a PPP.

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<sup>114</sup> EUR 6.1 trillion out a total for EU of EUR 23.4 trillion as of September 2016

- The level of participation to the product: in a similar spirit, the comparison of the number of PPP holders with the size of the population was used to measure the attractiveness of the product,
- The dynamic of the product: to capture the dynamic of the product the volume of annual in-payments was compared to the level of savings.

The methodology to measure penetration is to evaluate relative performance of the three aforementioned penetration indicators with respect to their respective trends. The points for each dimension are plotted on a logarithmic scale, in order not to give unfair advantages to any country based on its size, household financial assets or household savings - which would each yield greater performance indicators when small. A linear regression for each of the indicators outputs a trend line. The distance of each point to this line allows to measure how much above the trend (or under it) each PPP market stands. It is therefore counted positively if the PPP stands above the line, negatively if it stands under it. To give the same relative weight to each dimension in the final grade, this distance is divided by twice the standard deviation. The final grade is obtained by calculating the average for each of the three dimensions that are available for the product. The performance evaluates for the 36 products for which at least one of the three success indicator dimensions can be computed. The PPP with the highest penetration index according to this measure is the German PPP (Riester).

In terms of economic modelling, this indicator can be interpreted as a propensity to buy a PPP rather than use an alternative savings method. This can be used to model consumer choice as explained below.

## Step 2 - Modelling consumer choice

The model is developed on the assumption that consumers have the choice between a PPP and another product. The utility of consuming one unit of PPP and one unit of the other products is specified below:

$$U_{PPP} = \alpha_i + \pi_i \text{dummyfeatures} + \beta_i \text{Taxincentives} + \gamma_i \text{Age} + \delta_i \text{GDP} \\ + \theta_i \text{PensionSyst} + \mu_i \text{Assets}$$

$$U_{\text{other products}} = \Omega_i + \beta_i \text{Otherincentives} + \gamma_i \text{Age} + \delta_i \text{GDP} + \theta_i \text{PensionSyst} \\ + \mu_i \text{Assets}$$

In the above equations:

- The variable *Dummyfeatures* accounts for when there are several PPPs in one member state. This dummy variable takes a value of 1 for the most successful PPP (highest ranking) and a value of 0 otherwise. This dummy captures products features of the PPP that are deemed superior to other PPP features by consumers.
- Effective tax rates (OECD, 2004) were used to measure the strength of tax incentives associated to each PPP. These tax rates increase as the tax system becomes more burdensome. The difference in effective tax rates between the general tax regime and PPP tax regime were used as an indication of the ‘generosity’ of the tax relief. The variable *Taxincentives* corresponds to this difference. The larger is this indicator, the more generous is the tax relief.
- *Age* corresponds to the age of the PPP.
- The variable *GDP* denotes GDP per capita provided by Eurostat.

- *PensionSyst* corresponds to the proportion of old age income that is covered by the state. This variable is available from the OECD it aims at capturing the generosity of pension system.
- *Assets* denotes the percentage of household financial asset excluding currency and deposit.

Each coefficient in front of the above variables can be interpreted as the parameter which captures consumer's preferences.

Using the above equations we can define the latent variable  $Z$ :

$$\begin{aligned} Z &= U_{PPP} - U_{other\ products} \\ &= \alpha_i + \pi_i dummyfeatures + \beta_i Taxincentives + \gamma_i Age + \delta_i GDP \\ &\quad + \theta_i PensionSyst + \mu_i Assets - \Omega_i - \beta_i Otherincentives - \gamma_i Age \\ &\quad - \delta_i GDP - \theta_i PensionSyst - \mu_i Assets \end{aligned}$$

Given that the above utility parameters are invariant of consumer choices the above equation can be rewritten as:

$$Z = \alpha_i - \Omega_i + \pi_i dummyfeatures + \beta_i (Taxincentives - Otherincentives)$$

Individual maximizes utility when making consumption choices thus when:  $Z > 0$ , individual purchases the PPP product otherwise it purchases another product.

Assuming that  $Z \sim N(X\beta, \sigma^2)$  i.e. is normally distributed and that one unit is consumed, the market share of the PPP product then corresponds to the probability that  $Z$  is greater than 0. This leads to:

$$MS = \alpha_i + \pi_i dummyfeatures + \beta_i Taxincentives + \varepsilon_i$$

Our penetration index can be viewed as proxy of the market share. The larger this index the larger should be the market share and the reverse is true. This leads to the following relationship:

$$ranking\ index \sim \alpha_i + \pi_i dummyfeatures + \beta_i Taxincentives + \varepsilon_i$$

This relationship has been estimated with OLS (ordinary least square) regression and robust standard errors as shown in the table below:

Source	SS	df	MS			
Model	2.45031987	2	1.22515993	Number of obs =	27	
Residual	2.20578547	24	.091907728	F( 2, 24) =	13.33	
Total	4.65610534	26	.179080975	Prob > F =	0.0001	
				R-squared =	0.5263	
				Adj R-squared =	0.4868	
				Root MSE =	.30316	

penetration_index	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
fiscal_generosity	6.036024	1.328606	4.54	0.000	3.293916	8.778131
features	.2500307	.1243279	2.01	0.056	-.0065695	.5066308
_cons	-.6540773	.1937575	-3.38	0.003	-1.053973	-.2541815

The estimated relationship demonstrates the dominance of the tax incentive that clearly emerges from the literature as well. Product features play a much smaller role and by themselves would not lead to choosing the product (they are smaller than the (negative) intercept term).

As mentioned above the penetration index is a proxy of market share which itself can be expressed in terms of assets under management compared to all household financial assets.

### Step 3 - Estimating market potential

Using this relationship, one can estimate the market potential based on the assumption that consumers face the most favourable set of incentives present in the sample (the German Riester product).

If that was the case, a PEPP - that is at least as attractive as the most attractive current PPP - could attract a demand of around EUR 0.7 trillion. To get to this estimate in absolute terms, we have taken into account the distance in terms of estimated attractiveness for each existing PPP and we have weighted this distance by the assets under management as a share of total financial assets in the respective EU member state. Based on the model of consumer choice above, this mid-point estimate falls within a range of 0.4 to 1.0 trillion with a probability of 95%. As per the mid-point of EUR0.7 trillion, also the confidence interval assumes that PEPP would be granted the same tax treatment as the national pension products in all Member States.

Because for estimating market potential what matters is the distance of any national PPP to the German Riester product (as the one with the highest penetration/success index), the PEPP can be expected to crowd in some savings from alternative savings methods especially for those products that have the highest distance. Nothing could be inferred about the existing PPP schemes as they were not part of the alternative saving methods that have been modelled.

### Section C – Evolution of PEPP related investments asset classes under 3 scenarios

In order to then quantify the extra market-based funding available to the EU economy following the introduction of the PEPP, the following steps/assumptions have been taken:

- although PEPP is expected to be provided by different market players (e.g. insurance companies, asset managers, banks, etc.), it is assumed that, given the long term nature of these products, the closest available proxies in terms of possible asset allocation are pension funds; the estimated current asset allocation of pension funds is then retained as the "central portfolio" (see step 1)
- in order to take into account possible changes of economic fundamentals (that inevitably influence and modify the ultimate asset allocation) and to cater for different consumers choices when it comes to investment strategy options for their PEPP, two additional potential portfolio allocations ("conservative portfolio" and "growth portfolio") were also designed (see step 2)

## Step 1

In order to estimate the current pension funds' investment portfolio, the following sources have been considered:

- Mercer<sup>115</sup> which gathers annually detailed information about the investment strategy across the European pension industry (i.e. 14 EEA countries) from 1100 institutional investors with total assets of almost EUR1 trillion
- EIOPA<sup>116</sup> which collects information from around 1600 occupational funds in the EEA and total assets under management of EUR3.2 trillion
- OECD annual survey<sup>117</sup> which is based on a qualitative and quantitative questionnaire sent to the largest pension funds in the world (the data below refers to December 2014 and comprises 68 pension schemes with a total of USD3.7 trillion of assets under management)

Table B: Current asset allocation pension funds

MERCER		EIOPA		OECD	
<b>Total equity</b>	<b>32%</b>	<b>Equity</b>	<b>33%</b>	<b>Listed equity</b>	<b>30%</b>
- Domestic equity	21%	- Listed equity	29%		
- Non-domestic equity	11%	- Others	4%		
<b>Total bonds</b>	<b>51%</b>	<b>Debt securities</b>	<b>55%</b>	<b>Fixed income &amp; cash</b>	<b>55%</b>
- Domestic govern. bonds	26%	- Sovereign Bonds	34%		
- Non-domestic govern. bonds	4%				
- Domestic corporate bonds	15%	- Financial Bonds	12%		
- Non domestic corporate bonds	3%				
- Others	3%	- Other bonds	9%		
<b>Other investments</b>	<b>17%</b>	<b>Other investments</b>	<b>12%</b>	<b>Other investments</b>	<b>15%</b>
-Property	3%	- Real estate	7%	-Unlisted infrastructure	2%
-Alternatives	11%	- Other investments	5%	-Alternatives	13%
-Cash	3%				
<b>Total</b>	<b>100%</b>	<b>Total</b>	<b>100%</b>	<b>Total</b>	<b>100%</b>

Even though the level of granularity and detail<sup>118</sup> differ between the three sources, there is an overall consistency with the asset classes, which are then retained for the central

<sup>115</sup> "European Asset Allocation survey 2015" <https://www.uk.mercer.com/our-thinking/2016-european-asset-allocation-survey.html#contactForm>

<sup>116</sup> <https://eiopa.europa.eu/financial-stability-crisis-prevention/financial-stability/statistics> - the data shown in the table refers to December 2015 and excludes assets that are not related to the investment portfolio. Also UCITS invested amounts - 5% of invested portfolio - have been attributed to the main asset classes

<sup>117</sup> <http://www.oecd.org/daf/fin/private-pensions/2015-Large-Pension-Funds-Survey.pdf> - OECD 2016

<sup>118</sup> As noted in the International Organisation of Pension Supervisors 'Good Practices in the Risk Management of Alternative Investments by Pension Funds' (IOPS Good Practices) although there is no precise definition of "alternative investments", the term is usually applied to instruments other than listed equities, bonds, and cash. The nature of alternative investments is dynamic and ever-evolving, and closely linked to the development of financial markets. For the purposes of OECD and Mercer survey, "alternative" investments comprise the following types of investments: hedge funds, private equity, real estate, infrastructure, commodities and "other".

asset allocation portfolio and for the construction of the two additional portfolio allocations.

## Step 2

The table below shows the central portfolio (derived from the information collected in Step 1 and two additional potential portfolio allocations (conservative and growth portfolio).

Table C – The three portfolio allocations used in the simulations

Asset Classes Ranges	Central portfolio	Conservative portfolio	Growth portfolio
<b>Equity</b>	<b>33%</b>	<b>25%</b>	<b>40%</b>
-Listed equity	29%	22%	34%
-Other equity	4%	3%	6%
<b>Debt securities</b>	<b>55%</b>	<b>63%</b>	<b>46%</b>
-Sovereign Bonds	34%	40%	20%
-Financial Bonds	12%	13%	14%
-Other bonds	9%	10%	12%
<b>Other investments</b>	<b>12%</b>	<b>12%</b>	<b>14%</b>
-Real estate	5%	4%	6%
-Alternatives	4%	3%	5%
-Unlisted infrastructure	2%	2%	2%
-Cash	1%	3%	1%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

The conservative portfolio, compared to the central portfolio, is characterized by lower investments in risky assets (equity, real estate, alternatives) and more investments in safer assets (cash and debt securities including relatively more weight to sovereign bonds compared to financial and corporate bonds). The opposite reasoning was applied to the growth portfolio, with for example the notable increase in equity and decrease in debt securities. In the growth portfolio, the investment manager is expected to also increase the weight of risky/higher return/lower credit quality bonds, which explains the increase of investments in financial bonds and other bonds and the reduction in sovereign bonds.

While it is not possible to foresee the exact asset allocation (given the uncertainties around the preferred investment strategy option chosen by the PEPP holder and the future economic fundamentals), it could be reasonably assumed that the probable evolution would be within the three scenarios above. Indeed, the asset portfolio evolution from 2008-2015 shows that pension funds adjusted their strategic allocation according to the economic fundamentals and market sentiment. For example, the portfolio mix has been changing during the last 8 years with debt and other fixed income securities gaining more weight, while investments in equity and other variable-yield securities somewhat falling (against an overall higher volume of the AUM). The ranges are captured above in the growth and conservative portfolios.

Table D – The evolution of investment assets allocation from 2008 to 2015 – EIOPA statistical annex

Portfolio evolution IORPs - EIOPA	2015	2014	2013	2012	2011	2010	2009	2008
<b>Equity and other variable-yield securities</b>	33%	36%	36%	36%	37%	39%	40%	41%
of which Listed equity	29%	32%	32%	33%	35%	36%	39%	37%
of which other variable-yield securities	4%	4%	3%	3%	3%	2%	2%	4%
<b>Debt and other fixed income securities</b>	55%	52%	51%	50%	47%	45%	45%	43%
of which sovereign	34%	32%	31%	29%	28%	27%	27%	25%
of which financial	12%	11%	12%	13%	12%	11%	9%	8%
of which other	9%	9%	8%	9%	7%	8%	9%	10%
<b>Other investments</b>	12%	13%	13%	14%	15%	16%	15%	16%
Real estate investments	7%	7%	7%	7%	7%	7%	7%	8%
Other investments	5%	6%	7%	7%	8%	8%	7%	8%
<b>Assets under management (EUR trillion)</b>	<b>3.15</b>	<b>2.83</b>	<b>2.54</b>	<b>2.46</b>	<b>2.18</b>	<b>2.06</b>	<b>1.79</b>	<b>1.66</b>

## **Section D – How PEPP could help hedge households financial risks in the context of retirement**

This section of the Annex provides additional detail on the types of risks in table 7 in the main body of the impact assessment, and it provides the references to the literature reviewed.

### **RISK: Loss of capital, economic and financial cycle related risks**

Households' main residence remains one of the major savings mechanisms, but it often carries important **unhedged risks**. Reinhart and Rogoff (2009) have collected a vast history of housing market crashes and report losses in the region of 30-50% for house prices in advanced economies during adjustment in the 1970s, 1980s, and 1990s. Many advanced economies, including several EU Member States, have experienced significant negative adjustments since the 2007/8 crisis as well.

Households' main residence remains in many Member States<sup>119</sup> the most important savings method to protect against poverty in old age, also via a strong element of "forced savings" (see also section on Lock-In). However, mechanisms to extract the equity from houses by other means than selling the house have remained scarce. As a result, the **risk of having to sell the house at a particular point in time (around retirement)** continues to represent a major financial risk. Given the presence of pronounced house price cycles in many countries, having to sell the house during a bust or correction phase could wipe out large portions of life time savings. There is a need in a savings vehicle for the retirement age, and this is where a PEPP can rapidly make a huge difference.

### **RISK: Inflation**

A risk attached to currency and deposits, equities and securities discussed in the literature is **inflation**. Indexed bonds can provide protection against this risk. Private pension instruments, as argued by Feldstein (1981), thanks to their favourable tax treatment, have more than compensated for inflation and were therefore able to outperform direct holdings of equity or securities. While this argument in the literature is based on the U.S. experience, the logic carries over to European examples in those cases where similar advantageous tax treatments for personal pension products have been granted. This is the case that clearly emerges from regression analysis carried out on the data gathered in the commissioned study (referred to as EPPF study in the impact assessment).

### **IMPACT on savings: Lock In**

This is the strength of the pension promise; it is stronger the harder it is to get money out from any particular savings method. In the context of the discussion on the economic added value of a PEPP, the main risk attached to currency and deposits and its close substitutes is not inflation, but rather the lack of a commitment mechanism forcing the

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119 See, e.g., Household Finance and Consumption Survey (HFCS) conducted by the ECB, the second wave of which was published in December 2016 ([https://www.ecb.europa.eu/stats/ecb\\_surveys/hfcs/html/index.en.html](https://www.ecb.europa.eu/stats/ecb_surveys/hfcs/html/index.en.html)); another database on European countries is the LWS (Luxembourg Wealth Study) database (<http://www.lisdatacenter.org/our-data/lws-database/>)

household to preserve them until retirement. A PEPP could help households reasonably lock in savings until retirement (including in cases where the household is moving across jurisdictions pre-retirement). The importance of a lock-in can hardly be overestimated given the well demonstrated myopia of households that leads to sub-optimal levels of savings as risks at longer time horizons are systematically underestimated. PEPPs, if well designed, would provide a welcome alternative to real estate, the only alternative saving method with a very strong Lock-In, while avoiding some of the major risk attached to real estate (see above).

### **IMPACT on savings: Financial literacy, product design, online distribution and advice**

Households with low financial literacy are more exposed to housing market and mortgage credit related risks. At the same time they will be less likely to buy a PEPP. On the other hand, simple and clear design features of PEPPs can help increase financial literacy. The potential benefits of such increases are considered very significant based on findings in the literature (see Lusardi and Mitchell 2014 for an overview). In addition, PEPPs under the preferred option could create a powerful market segment for Fintech online comparison tools, including those based on Big Data and advanced data analytics.<sup>120</sup>

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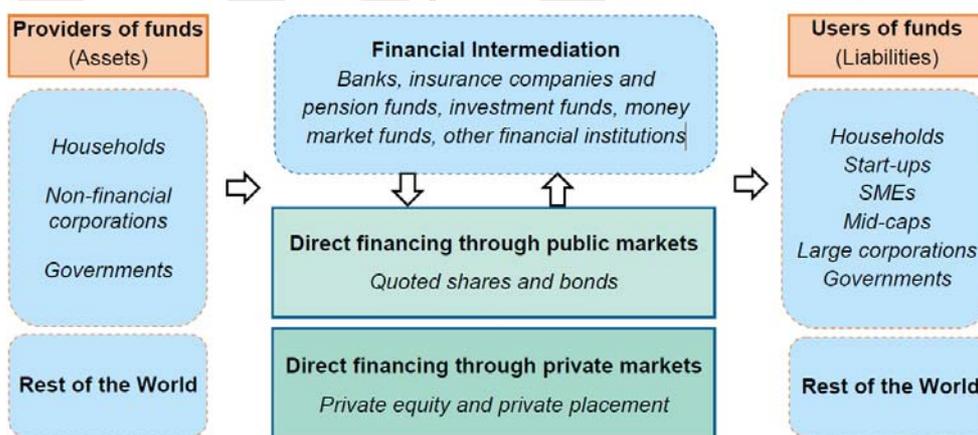
<sup>120</sup> The literature mentions a few caveats that should be kept in mind, however: Fintech providers of online comparison tools should ideally not be vertically integrated with PEPP providers. Even so, consumers may voluntarily disclose sufficient personal data using the online comparison tool to build a database that can track PEPP performance over time and match such performance to household characteristics. Challenges would remain given the demonstrated behavioural constraints households are facing when using online tools.

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## Section E – Capital markets and funds stocks in the EU

In broader sense capital markets consist of debt and equity markets that intermediate funds between savers and those that need capital. Capital markets financing is often labelled "direct", because it occurs through direct exchange of securities between investors and borrowers. This differs from "indirect" financing via financial intermediaries, notably banks, which collect deposits from savers and lend funds to borrowers. The latter is also referred to as the "bank-based model", as opposed to the "market-based model" in the case of direct financing. Whilst capital markets are predominantly concerned with direct financing, they are also closely interlinked with financial intermediaries who are themselves active on capital markets. Figure I below attempts to capture the main thrust of the flow of funds in an economy whereas capital markets and financial intermediaries link providers of funds and users of funds. Capital markets can be subdivided into private and public markets. The private equity market, for example, is an important source of funds for start-ups, middle-market (so-called midcap) companies, firms in financial distress and public firms seeking buyout financing. Other segments include quoted shares and bonds and the market for private placement debt.

Figure I – Flow of funds in an economy from providers of funds (left) to users of funds (right)



The size of capital markets depends on the volume of funds being channelled. Ultimately, this depends on the willingness of ultimate savers to turn to other forms of financial asset holdings than bank deposits. Households are the principal net savers in the economy, whilst both the public sector and non-financial corporations (NFCs) are the ultimate debtors (see Figure II below).

Figure II – Data on funds stocks as of December 2015 – Billion EUR

Provision of funding (financial assets)			Financial intermediation (assets)		Use of funding (financial liabilities)			
55,987	Households	33,369	84,277	Monetary and Financial Institutions	44,157	58,429	Households	10,047
	Non financial corporations	17,044		Other financial intermediaries**	40,120		Non financial corporations	33,035
	Governments	5,574					Governments	15,347
			Public capital markets					
			34,220	Bonds	23,775			
				Stocks	10,445			

Source: Eurostat – Consolidated data; \*\*Other financial intermediaries: insurance companies, investment funds, pension funds and others

Capital market activity has increased significantly in the EU over the last two decades.

According to ECMI<sup>121</sup> between 1995 and 2015, the total EU stock market capitalisation has progressed from EUR 2.7 trillion (27% of GDP) to EUR 10.4 trillion (71% of GDP), whilst the total value of outstanding debt securities has grown from EUR 5.9 trillion (84% of GDP) to EUR 23.8 trillion (162% of GDP). Nonetheless, a number of EU capital markets remain relatively underdeveloped at least compared to the US<sup>122</sup> also due to the fact the Europe has traditionally relied more on bank finance.

<sup>121</sup> The European Capital Markets Institute (ECMI) is an independent think-tank, within the Centre for European Policy Studies (CEPS)

<sup>122</sup> For example while Europe' economy is slightly lower than the US economy, in the US markets for public equity are almost double in size (142% vs. 71% in the EU) and so are private equity markets.

## ANNEX 5: GLOSSARY AND LIST OF ABBREVIATIONS USED

Accumulation phase	The period during which funds are accumulated (in-payments) in the pension product and usually runs until the age of retirement.
Annuity	A sum payable at specified intervals, mostly annually, over a period, such as the recipient's life or a certain number of years, in return for a premium paid either in instalments or in a single payment.
AuM	Assets under management.
Biometric risks	Risks linked to death, disability and longevity.
Capital Market Union (CMU)	An Action Plan of the European Commission to mobilise capital in Europe.
Decumulation phase	The period during which accumulated assets are drawn upon to fund retirement or other income requirements. Sometimes also referred to as payout phase.
Debt	Borrowings in the form of loans or bonds.
Defined benefit (DB) schemes	Pension schemes where the benefits accrued are linked to earnings and the employment career (the future pension benefit is pre-defined and promised to the member). It is normally the scheme sponsor who bears the investment risk and often also the longevity risk: if assumptions about rates of return or life expectancy are not met, the sponsor must increase its contributions to pay the promised pension. These tend to be occupational schemes (see also: Defined contribution (DC) schemes).
Defined contribution (DC) schemes	Pension schemes where the level of contributions, and not the final benefit, is pre-defined: no final pension promise is made. DC schemes can be public, occupational or personal: contributions can be made by the individual, the employer and/or the state, depending on scheme rules. The pension level depends on the performance of the chosen investment strategy and the level of contributions. The individual member therefore bears the investment risk and often makes decisions about how to mitigate this risk (see also: Defined benefit (DB) schemes).
Delegated Acts	Article 290 of the TFEU allows the EU legislator to delegate to the Commission the power to adopt non-legislative acts of general application that supplement or amend certain non-

	<p>essential elements of a legislative act.</p> <p>For example, in Solvency II, the EU legislators have delegated the power to the Commission to adopt implementing rules.</p>
Depository	An institution charged with the safe-keeping of assets and oversight of compliance with the fund rules and applicable law.
Directive	A legislative act of the European Union, which requires Member States to achieve a particular result without dictating the means of achieving that result. A Directive therefore needs to be transposed into national law - contrary to Regulations that have direct applicability.
ECB	European Central Bank.
EIOPA	<p>EIOPA is the European Insurance and Occupational Pensions Authority, which replaced CEIOPS on 1 January 2011 in the context of European System of Financial Supervision. EIOPA is an independent Authority.</p> <p>EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.</p>
ESMA	ESMA is the European Securities and Markets Authority and part of the European System of Financial Supervision.
Funded scheme	A pension scheme whose benefit promises are backed by a fund of assets set aside and invested for the purpose of meeting the scheme's liability for benefit payments as they arise. Funded schemes can be either collective or individual (see also: Pay-As-You-Go schemes).
GDP	Gross domestic product.
Hybrid pension scheme	A pension scheme with both Defined Contribution and Defined Benefits elements or, more generally, a scheme where the risk is shared by the scheme's operator and beneficiaries.
IDD	Insurance Distribution Directive, setting rules for the sale of insurance products and insurance-based investment products by insurance intermediaries and insurance companies (Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution)
Information disclosure regulations	The rules prescribing the periodicity, procedure, type and extent of information to be provided to members of pension products and/or the supervisory authority.
Institutional	Generally refers to a group of investors such as pension funds,

investor	insurance companies, investment funds and, in some cases, banks.
IORP	Institutions for occupational retirement provision (IORP): financial institutions that manage collective retirement schemes for employers to provide retirement benefits to their employees (i.e. pension scheme members and beneficiaries).
Lump sum	Payment of an amount in one single payment.
Markets in Financial Instruments (MiFID / MiFID II / MiFIR)	Set of financial legislation laying down rules for the authorisation and organisation of investment firms, the structure of markets and trading venues, and the investor protection regarding financial securities.
OECD	The Organisation for Economic Co-operation and Development is an international economic organisation of 34 countries founded in 1961 to stimulate economic progress and world trade.
Occupational scheme	A pension plan where access is linked to an employment or professional relationship between the plan member and the entity that sets up the plan (the plan sponsor). Occupational pension schemes may be established by employers or groups of employers (e.g. industry associations) or labour or professional associations, jointly or separately, or by self-employed persons. The scheme may be administered directly by the sponsor or by an independent entity (a pension fund or a financial institution acting as pension provider). In the latter case, the sponsor may still have responsibility for overseeing the operation of the scheme.
Pay-As-You-Go (PAYG) schemes	Pension schemes where current contributions finance current pension expenditure (See also: funded schemes).
Pay-out phase	The period during which a person receives income from pension savings accumulated before retirement.
Pension protection scheme	An arrangement to pay compensation to members or beneficiaries of pension schemes in the event of insolvency of to the pension fund and/or sponsoring employer. Examples of a pension protection scheme include the Pensions-Sicherungs-Verein Versicherungsverein auf Gegenseitigkeit (PSVaG) in Germany and the Pension Protection Fund in the UK.
Pension gap	The pension gap is the difference (or gap) between the pension individuals on an aggregated basis can currently expect to receive (from a possible combination of state, workplace and personal pensions) and the amount individuals on an aggregated basis are likely to need for an adequate standard of living in

	retirement.
Pension pillar	Different types of pension schemes are usually grouped into two, three, four or more pillars of the pension system. There is however no universally agreed classification. Many pension systems distinguish between statutory, occupational and individual pension schemes, or between mandatory and voluntary pension schemes. Participation in occupational and individual pension schemes, usually private pension arrangements, can be mandatory or voluntary.
Pension Scheme	A contract, an agreement, a trust deed or rules setting out the retirement benefits that are granted and their conditions.
Portability of occupational pensions	It refers to the transferability of occupational pension rights. The Directive on improving the portability of supplementary pension rights provides minimum requirements for the acquisition and preservation of pension rights for mobile citizens.
PPP	Personal pension products.
PRIIPs	Regulation on the format and content of key information documents to be drawn up by manufacturers of packaged retail and insurance-based investment products (Regulation (EU) No 1286/2014 of 26 November 2014 on key information documents for packaged retail and insurance-based investment products).
Public or state pension	Public pensions are those provided by the state or local government and financed from social security contributions or general tax.
Occupational or workplace pension	Occupational pension schemes are when the employer organises a pension scheme for its employees. See also IORP.
Replacement rate	Generally refers to an indicator showing the level of pension income after retirement as a percentage of individual earnings at the moment of take-up of pensions or of average earnings. Replacement rates measure the extent to which pension systems enable typical workers to preserve their previous living standard when moving from employment to retirement.
Regulation	A legislative act of the European Union legislation which has direct legal effect in the Member States' legal order.
Regulator /Supervisor	A regulator/supervisor is a public authority designated by a Member State to supervise that country's financial markets.
Retail investor / client/ saver	A person investing his/her own money on a non-professional basis.

Small and medium sized enterprises (SMEs)	On 6 May 2003 the Commission adopted Recommendation 2003/361/EC regarding the Small and medium sized enterprise definition. While 'micro' sized enterprises have fewer than 10 employees, small have less than 50, and medium have less than 250. There are also other criteria relating to turnover or balance sheet total that can be applied more flexibly.
Solvency II	Solvency II is the usual denomination of Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance.
Supplementary pensions	Mandatory or voluntary occupational or personal pension schemes which generally provide additional retirement income to the state based pension scheme.
Undertakings for Collective Investment in Transferable Securities Directives (UCITS)	Undertakings for Collective Investment in Transferable Securities Directives, a standardised and regulated type of asset pooling.

## ANNEX 6 - MARKET DESCRIPTION OF PERSONAL PENSIONS

### 1. Introduction

The current EU market for personal pensions is mainly locally organised, mainly due to linkages with local tax, social and contractual laws. As a consequence, market data is fragmented and also diverse, also due to the varying classification in the various Member States of pension assets in state pensions, occupational pensions and private pension (see also Introduction, Box 1).

Three broad sources of market data have been used to get a broad picture of the EU private pension market:

- 1) OECD data<sup>123</sup>
- 2) EIOPA data<sup>124</sup>

#### 1. OECD Statistics on private pensions

The 2016 OECD report on private pensions contains the following main messages as regards the worldwide private pensions market:

##### **a. Private pension assets are worth more than USD 38 trillion and are mainly managed by pension funds**

Private pension assets reached USD 38 trillion worldwide in 2015. Assets invested through all pension vehicles in financial markets amounted to USD 36.9 trillion in the 35 OECD countries in 2015, and amounted to USD 1.3 trillion in a sample of 45 non-OECD countries. Pension funds were the main investors of these assets worldwide (USD 26 trillion, 68% of the total), followed by banks and investment companies (USD 7.7 trillion, 20.2%), insurance companies (USD 4.3 trillion, 11.3%) and employers through their book reserves (USD 0.2 trillion, 0.5%).

##### **b. The importance of private pension systems across countries is uneven**

The size of investments through pension vehicles varies across countries. The largest values of invested assets in USD values are located in North America (United States, Canada), Western Europe (United Kingdom, Netherlands, Switzerland), Australia and Japan. Private pension invested assets are also high when compared to the size of the domestic economy in other countries, such as Chile, Denmark and South Africa, where they accounted for 70%, 206% and 97% of GDP in 2015, respectively. Private pension assets, however, still represented around, or less than, 20% of GDP in more than 50 countries in and outside the OECD area in 2015.

### 2. Market Description from the EIOPA technical advice

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<sup>123</sup> Pension statistics and periodic reports:

<https://www.oecd.org/daf/fin/private-pensions/Pension-Markets- in-Focus-2016.pdf>

The EIOPA technical advice on personal pensions confirms that the market take-up of personal pensions is low. The advice states that assets under management for personal pensions represent 1.1 Trillion Euro, representing only 67 million of savers (approximately 13% of the total population of the European Union). It should be noted that the definition in the EIOPA technical advice is distinct from the EPPF study, as the first also covers to some extent occupational pensions. Nevertheless, both studies indicate an overall low market take-up of personal pensions in the European Union.

The chart below presents a breakdown of the volumes per Member State, and compares it to the population per Member State. It reflects important differences in volumes per Member State as compared to population. It should be noted that the need for developing 3<sup>rd</sup> pillar personal pensions also depends on the retirement income to be expected of first and second pillar pensions in the respective Member States. It shows that personal pension markets are well developed in Belgium, Germany, the Netherlands and the UK, since in these Member States the share of personal volumes expressed as a percentage of the total EU volumes is significantly higher than the share of the population as a percentage of the total EU population.

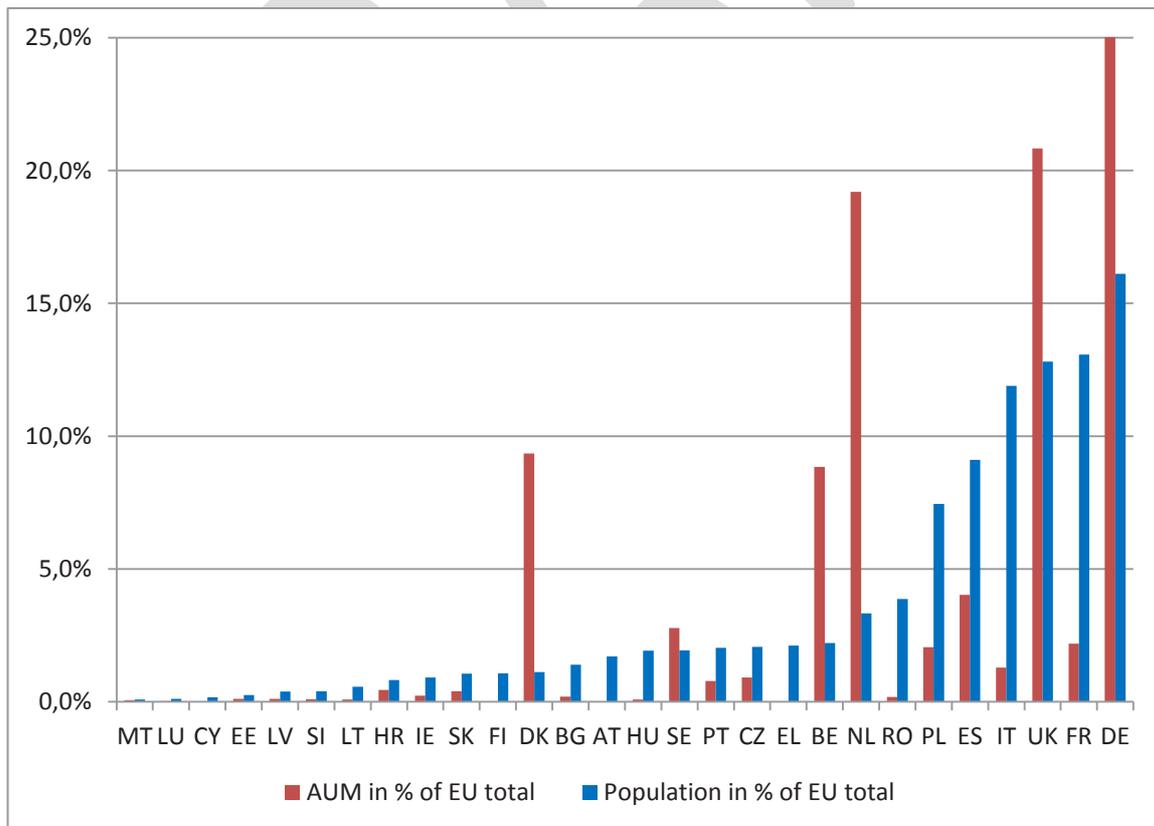
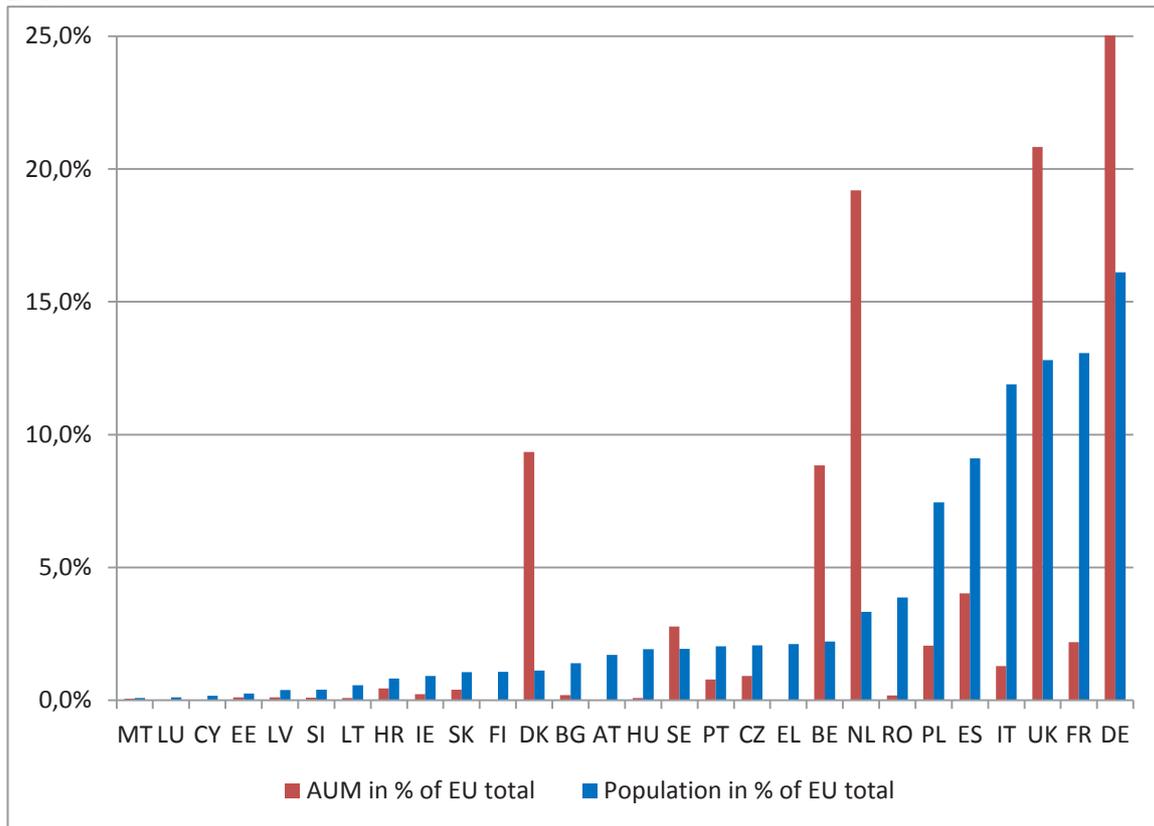
Based on Chart 1, the largest market potential for PEPP's can be expected in countries that have less developed pension markets and which are mostly in the eastern and southern part of the European Union. Providers from Member States with better developed "third pillar" pension systems could benefit from increased possibilities of cross-border provision of PEPPs. There is a significant potential for development in Spain, France, Italy, Poland and Romania<sup>125</sup>.

*Chart 1: Assets under management (AUM) in personal pensions compared to total population by Member State, in percentage, in*

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<sup>125</sup> For the following Member States data were missing: Austria, Cyprus, Greece and Finland.

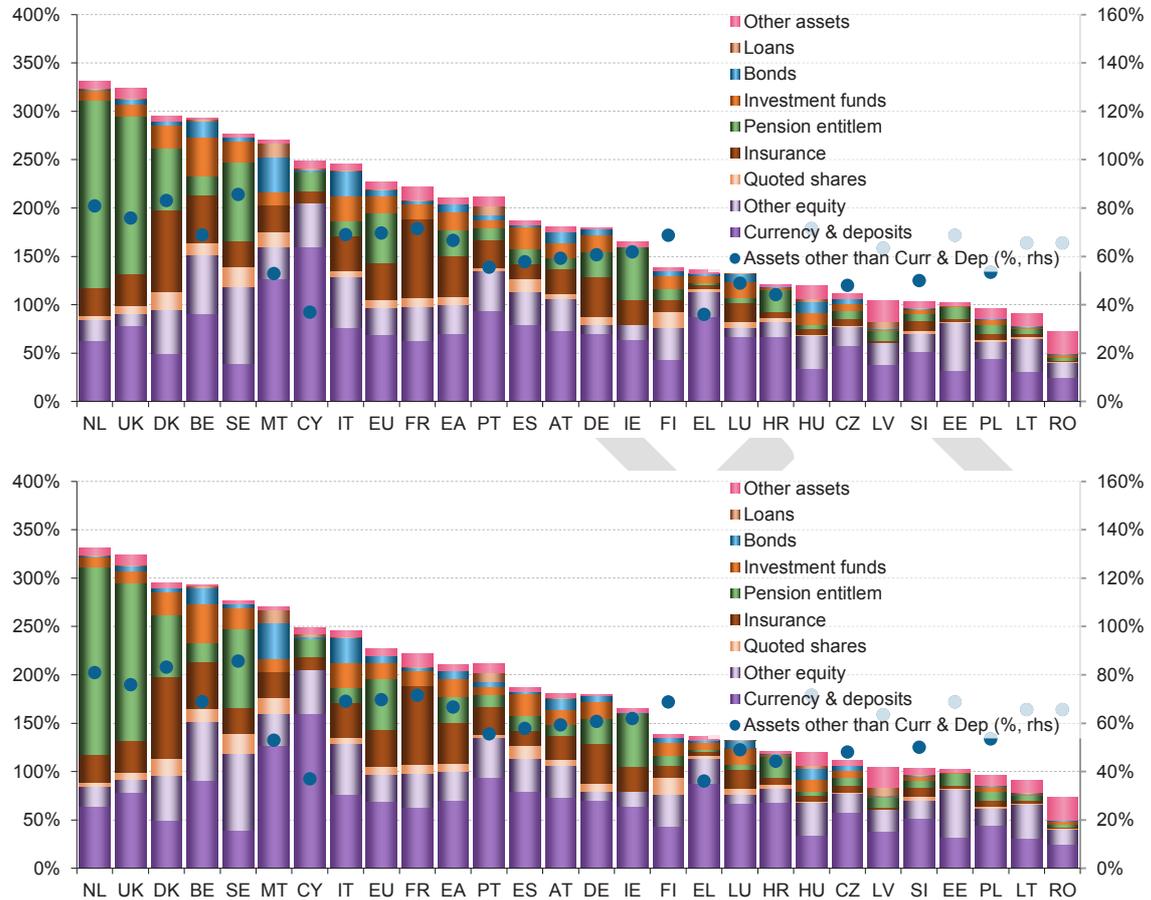
2015.



Source: EIOPA, Eurostat

Chart 2 below, shows important household funds available in the form of deposits. If only a small part of these funds could be channelled in third pillar pension products, they could be transformed in long term investments contributing to the objective of a CMU.

*Chart 2: Household assets (provision of funding by instrument, 2015, percentage of GDP)*



Source: EFSIR report 2016

**ANNEX 7 – SYNTHESIS OF POLICY OPTIONS FOR THE PEPP FEATURES (KEY AND OTHER FEATURES)**

Name	Description	Possible preferred options (and policy)	Pros and cons	Stakeholder preference
<b>Key features</b>				
Distribution	<p>Distinct distribution channels can be employed to sell PEPPs to individuals. These include traditional channels such as physical distribution, an agents network, or online distribution.</p> <p>Advice ensures that individuals obtain the most favourable outcomes. Advice at the time of sale of the product could be beneficial.</p> <p>Precontractual information requirements ensure that individuals make well-informed choices in PEPPs. Main issues: type of information, timing and format of</p>	<p>a) Existing sectoral legislation applies</p> <p>b) Full standalone regime for PEPP</p> <p>c) <u>Combination of specific add-on rules with application of sectoral rules</u></p>	<p>a) is simple and respects sectoral specificities. b) and c) possibly distortive on competition and adds to costs base of providers. Hybrid could combine sectoral and PEPP specific advantages: ensure coherence between sectoral regimes and long term PEPP purpose.</p>	<p>Retail investors in favour of simple and inexpensive distribution system based on electronic sales of non-complex products.</p> <p>Consumer associations favour simple and inexpensive advice system aimed at younger generations including online advice. Some consumer organisations were opposing mandatory advice to avoid risks of miss-selling of the product in case of biased advice.</p> <p>If advice is provided, it should be independent to allow for appropriate choice of the product.</p>

	disclosures.  Ongoing disclosure would be provided for in any PEPP regime			
Investment options and mitigation of investment risks – for PEPP savers	Investments of the funds would determine the outcome of the product at the age of retirement and should take into retirement objective, allow for an appropriate balance between risk and returns and take into account individual's needs. Main topics are the default option and alternative investment options.	<ul style="list-style-type: none"> <li>a) No requirements for risk mitigation</li> <li>b) <u>Type of capital protection mandatory for the default option, risk mitigation technique mandatory for the other investment options (choice left to the provider)</u></li> <li>c) Type of capital protection mandatory for all investment options</li> </ul>	b) would provide additional consumer protection, encourage take-up and enhance cross-border development through standardisation of the default option. Capital protection could be offered by all providers, except for asset managers where 'life cycling' would be the alternative for providing financial guarantee.	Consumer organisations consider that savers should be sufficiently protected for their savings for retirement. In particular they request to ensure that at least the funds saved would be available on retirement, possibly corrected for inflation. Providers consider that multiple possibilities for mitigation of investment risk should be available and that it is up to the provider to determine the applied risk mitigation technique.
Investment rules for PEPP providers		<ul style="list-style-type: none"> <li>a) No investment rules for PEPP providers</li> <li>b) <u>Introduce a general principle of prudent investment</u></li> <li>c) Introduce investment targets</li> </ul>	Avoid too detailed investment regulation to allow for greater take-up on the provider side	All providers requested flexibility as regards investment options.
Switching of providers	After signature of the contract, individuals might want to switch from one provider to another. To what extent	<ul style="list-style-type: none"> <li>a) (baseline) No requirements for switching</li> <li>b) Switching without costs</li> </ul>	d) offers maximum in terms CMU perspective and more so if periodic switching is framed.	Individuals and consumer organisations request flexible switching of providers, preferably

	should switching be flexible and under which conditions can it be limited?	<p>c) Switching with costs</p> <p>d) <u>Cap on exit costs</u></p>	Balance between consumer protection and boosting competition	<p>without costs.</p> <p>Providers consider that switching should in principle be possible, but limited in view of the long term nature of the product. Under certain financial market situations switching can be very expensive for providers. Some providers request a minimum duration to hold the product and other request switching should be subject to exit costs.</p>
Portability	Portability concerns how to deal with individuals moving cross-borders while maintaining the same product and provider.	<p>a) No specific provision on cross-border portability and supply</p> <p>b) <u>enhance mobility by standardising information exchange between supervisors + ensuring information flows on pensions in home and host MS and ensure transferability of assets within a PEPP</u></p>	b) could trigger tax exit charges but achieves maximum portability allowing for costs reduction by standardisation and economies of scale.	Individuals and consumer organisation consider that portability is very important, especially for mobile workers.
Decumulation	The product phase after the age of retirement.	<p>a) (baseline) No requirements on the form of decumulation</p> <p>b). Mandate one decumulation option (e.g. annuities)</p> <p>c) <u>Mandate flexibility of decumulation PEPP providers should be allowed to develop all</u></p>	c) offers maximum level playing field between providers, flexibility as to national regimes.	Individuals, Consumer associations, and providers request flexibility as regards the decumulation options. Insurers request to take into account the

		<u>possible types of decumulation.</u>		retirement objective for the decumulation phase.
<b>Other features</b>				
Regulation of costs and charges	In view of the impact on returns, the question is whether these should be regulated and, if this is the case, under which parameters.	a) Establish a cap on costs and charges, based on product features and market conditions.  b) <u>Establish transparency based requirements based on PRIIPs, IDD, IORP II).</u>	Specific regime benefits level playing field between providers, enhances return for savers and enhances competitive pricing.	Individuals and consumer organisations consider that costs and fees should be transparent and low, possibly capped to a maximum.  Providers consider that transparency of fees should be sufficient to ensure competition.
Guarantee for biometric risk		a) <u>Member States' option</u> b) Mandatory guarantee on biometric risk	a) provides maximum level playing field between providers and better possibility to tailor for local tax regimes.  b) could possibly exclude asset managers consequences in terms of potential providers and limiting the market to insurers, pension funds, banks.	Some MS in favour of strong consumer protection. Low demand by consumer organisations for such guarantee
Depositary	An additional safeguard for	a) Do not mandate an independent depositary	b) allows avoiding fraud	No preferences

	investors could be to introduce depository function to reduce fraud/custody risks	function b) <u>Mandate an independent depository function</u>	or custody risk in the management (or valuation) of assets and ensure that assets of scheme are not lost in case of bankruptcy of the PEPP provider	expressed
Other elements of prudential supervision		a) <u>PEPP providers subject to their respective current EU regimes</u> b) PEPP providers subject to a new EU regime	Better investor protection although additional costs in addition to risk mitigation.	Some MS in favour of strict prudential requirements.

## ANNEX 8 – DISTRIBUTION: DESCRIPTION OF POSSIBLE ADD-ON PROVISIONS

This Annex presents in detail possible policy options on advice, information to the PEPP saver and electronic distribution.

**Advice:** In light of the importance of the decision regarding the choice of PEPPs for retirement in income (depending on other sources of wealth), savers should benefit from appropriate advice prior to a final decision – except in well-delineated circumstances. The PEPP framework should ensure that PEPP savers all over the single market can get a personal recommendation based on an in-depth assessment of their financial situation and investment objectives<sup>126</sup>. The relevant provision could build on the suitability test that exists already in MiFID II and IDD and adapt it to the specific retirement objective of the PEPP.<sup>127</sup>

Retail investors should, however, also have the possibility to buy the PEPP in its default option without in-depth advice. This exception would again follow the model of MiFID II and IDD<sup>128</sup>. It would be justified by the fact that the default option would have to be strictly limited to clearly defined low-risk investments. The possibility of a sale without advice in the low-risk configuration would come close to a proposal by consumer organisations for a simple product that can be marketed over the internet without advice. This would save costs of advice for providers and allow for easy online and cross-border sales. It could also help to improve the take-up of PEPPs in particular with younger consumers who might be reluctant to undergo advice sessions for their retirement planning. On the other hand, buyers would have to be aware that in an advised sale they could obtain a product that might be better adapted to their demands and needs. Still, given the low-risk profile of the default option, this choice could be left to the consumer.

When asked whether they consider that there should be mandatory advice for the provision of personal pensions, the greater part of business representatives (mostly insurers, pension funds, banks, as well as their associations) participating in the Public Consultation reply that pensions products are normally long-term products that require individual advice, regardless of distributed on provisions or fees. Given the fact that members and potential members of personal pension schemes are not always sufficiently financially literate, advice is seen as important and mandatory. However, there are views (mainly from think tanks and smaller companies) that advisory services should not be mandatory and should be linked to the complexity and costs of the PPP, taking into account the situation of every member. It is stressed that some consumers have knowledge and experience to make their own decisions.

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<sup>126</sup> In the existing sectorial EU legislation, rules on advice are based on a distinction between two levels: In an assessment of suitability, the distributor obtains information on (a) the customer's knowledge and experience in the relevant investment field, (b) the customer's financial situation and (c) the customer's investment objectives in order to recommend a product that is suitable for the customer (see Article 25(2) MiFID II and Article 30(1) IDD). In the more limited assessment of appropriateness, the distributor must only obtain information about the customer's knowledge and experience in the relevant investment field in order to assess whether the product is appropriate for the customer (see Article 25(3) MiFID II and Article 30(2) IDD).

<sup>127</sup> Financial Services Authority, Suitability Standards for advice on personal pensions: feedback on CP05/08" Feedback Statement, FS07/01 (2007), [http://www.fsa.gov.uk/pubs/cp/fs07\\_01.pdf](http://www.fsa.gov.uk/pubs/cp/fs07_01.pdf) (accessed 14 January 2017).

<sup>128</sup> See Article 25(4) MiFID II, Article 30(3) IDD. In the case of IDD, Member States have the option to allow execution-only sales.

**Pre-contractual product information:** The PEPP framework should also provide for appropriate rules on pre-contractual product information documents. In this respect, it should as far as possible build on the application of the PRIIPs Regulation while adapting the KID to the PEPP's retirement purpose to enable investors to select the most appropriate pension product. A specific PEPP KID would contribute to creating the specific "PEPP" label, set a level-playing field between providers, and maximise the distribution potential of the product.

On the Public Consultation question on what information is most relevant to individual savers before signing up to a product, the respondents from all business fields almost unanimously consider the information on the tax regime for contributions, returns and pay-outs as very important. The information on the provided level of protection is also assessed as being such. The opinions are more divided (between the assessments "very important" and "fairly important") on the information about available investment options, different types of fees and level of fees disclosed annually. Less importance seems to be assigned by the professional stakeholders to the information on the rate of return over the last two years and on information provided in a standardised format (similarly to the PRIIPs KID).

**Inducements:** Conflicts of interest in the context of the payment of commissions and other forms of inducements, are a major source of mis-selling and loss of trust on the side of consumers. Consumer organisations have consistently required effective mechanisms of management of conflicts of interest and protection against abusive inducements. It would therefore be advisable to provide add-on rules ensuring an appropriate common standard of protection which could be modelled on the standards of existing EU legislation (MiFID II, IDD). This would ensure a level playing field for distributors while guaranteeing high professional standards for consumers.

**Information during the contract:** The PEPP framework should ensure regular, relevant and comprehensive information of customers about key data of their PEPP during the contract life, such as the development of the investments and estimated pension entitlements. The relevant provisions could build on the IORP II<sup>129</sup> provisions to inform members during accumulation (including the Pension Benefit Statement<sup>130</sup>) and beneficiaries during decumulation<sup>131</sup>. This would allow PEPP savers to take, where necessary, action by modifying the product, adapting the underlying investment assets or even switching the provider. Providers would have to incur additional costs for providing the information. However, it should already be a general practice in the industry to provide customers of PPPs with a certain amount of regular information so that they would only have to adapt their procedures.

Asked in the Public Consultation about what information is most relevant to individual savers during the lifetime of the product, professional stakeholders are almost unanimous (whatever their business field) that the information on accumulated benefits, the level of fees and on the tax treatment of savings is of utmost importance, although the other types

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<sup>129</sup> Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast) (OJ L 354 of 23 December 2016, p. 37).

<sup>130</sup> See Articles 38 to 40 and Article 42 of the IORP II Directive.

<sup>131</sup> See Articles 43 to 44 of the IORP II Directive.

of information (current and available investment options, the rate of return, the level of protection provided and the expected benefits at retirement) are also assessed as being of certain significance.

**Electronic distribution:** In view of the need to focus distribution of PEPPs on younger people ("generation Y" or "millenials", digital natives) so that they start accumulating in their early years, the distribution regime would have to facilitate internet distribution. According to the professional stakeholders (whatever their sector) who responded to the Public Consultation, the distribution channel mostly favoured by them in order to maximise the benefits and efficiency gains of a Single Market for personal pensions is the online channel.

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## ANNEX 9 - COST OF SWITCHING AND ADVICE

### A. SUMMARY FINDINGS

Consumers usually incur costs in three areas (financial advice, investment related expenses and cost of switching). These should be considered separately in our assessment. Publicly available data shows the following range of costs in each area.

#### **1. Costs of financial advice (including pensions advice)**

Typically the service of providing financial advice involves an initial consultation (which is charged fixed or hourly) or fees on AUM or a combination of both.

- Hourly rate - £75/€87 to £350/€406. UK average £150/€174 (*www.unbiased.co.uk, March 2016*)
- Full pension advice (at retirement) - £2500/€2900 on a pension pot of £200,000/€232,000 (1.25%)
- Some advisors charge 1%-2% per annum through the life of the investment, but there are no clear statistics of how much the advice costs as a percentage of total expenses incurred by the consumer.

#### **2. Total investment related expenses (as percentage of AUM<sup>132</sup>)**

- 1% expenses incurred by investors in funds (*Source: Morningstar, August 2016*)

#### **3. Cost of switching**

This cost depends on the asset class (which drives the bid-offer spread) and surrender charges for individual funds.

- The bid-offer spread can be up to 5% of the value of the investment.
- Early surrender charges can be between 1% to 5% depending on the time for which the investment is held.

In summary:

- For an investment portfolio of €200,000 a two-hour consultation with a financial advisor would cost circa 0.17% of the portfolio value (and in addition, in some cases may have a 1% per annum advisory cost).
- Assuming the investment is made in standardised (UCITS type) funds, the annual expenses related to the investment would be roughly 1%-1.5% per annum.
- Switches, if performed regularly, would be prohibitively expensive. However, for major asset relocation, the one-time cost could range from 1% up to 5%.

<sup>132</sup> AUM = Assets under management

*Note- The above figures are based on publicly available data and do not necessarily represent the costs in a newly designed PEPP product.*

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## **B. DETAILED FINDINGS**<sup>133</sup>

### **Source 1 – (UK) How much does a financial adviser charge?**<sup>134</sup>

A financial adviser's fees vary depending on what they are charging for and how consumers pay. These include:

- An hourly rate - this will vary from £75 an hour to £350, although the UK average rate is about £150 an hour.
- A set fee for a piece of work -this could be several hundred or several thousand pounds.
- A monthly fee -this could be a flat fee or a percentage of the money a consumer intends to invest.
- An ongoing fee -an adviser can only charge an ongoing fee in return for providing an ongoing service, unless the consumer is paying off an initial charge over time through a regular payment product.

### **Source 2 – (UK) How much does a financial adviser charge?**<sup>135</sup>

Typical ways that advisers may charge include:

- Fixed fee – The adviser will perform a specific service (such as setting up an annuity) for a set price agreed in advance.
- Percentage of assets – An adviser who is managing your investment portfolio over a period of time may charge a percentage of the portfolio's total value, rather than a fixed fee.
- Hourly rate – Some advisers may charge an hourly rate for certain services (£150 per hour is the UK average).

Typical costs work out as follows:

	<b>Advice scenario</b>	<b>Typical cost*</b>
<b>General</b>	Initial financial review / review	£500
<b>Investment</b>	Advice and set up of £11,000 investment ISA	£450
	Investment strategy for a £50,000 inheritance for a 50yr old seeking medium term growth	£1,500
<b>Retirement planning</b>	Advice on an £80 a month pension contribution	£500
	Advice on a £200 a month pension contribution	£580
	Advice on transferring a £30,000 pension with guaranteed	£900

<sup>133</sup> Exchange rates used in this note £1=€1.16

<sup>134</sup> Source: Money Service Advice UK. Link to the article is [here](#).

<sup>135</sup> Source: Unbiased.co.uk. Link to the article is [here](#).

	<b>Advice scenario</b>	<b>Typical cost*</b>
	annuity rates	
	Advice on transferring a £100,000 pension with guaranteed annuity rates	£2,000
	Specialist advice on defined benefit transfer	£1,500
<b>At retirement</b>	Converting a £30,000 pension fund into a lump sum and annuity	£825
	Converting a £100,000 pension fund into a lump sum and annuity	£1,750
	At retirement advice on £100,000 pension pot (client requires full advice)	£2,000
	At retirement advice on £100,000 pension pot (client knows what they wish to do)	£1,000
	At retirement advice on £200,000 pension pot (client requires full advice)	£2,500
	At retirement advice on £200,000 pension pot (client knows what they wish to do)	£1,100
	Set up of a drawdown scheme on a £300,000 pension pot	£3,500
	At retirement advice where the client has a £200,000 SIPP, some DB income, £100,000 of investments and a £250,000 investment property, incorporating estate planning	£5,000

### **Source 3 – (IE) Charges on unit-linked funds?<sup>136</sup>**

The charges that may apply to unit linked funds are:

- Allocation rate - the percentage of investment that is used to buy units in a fund. A 98% allocation rate means that for every €100 you invest, the investment company invests €98 and takes €2 as a charge.
- Bid/offer spread - the difference between the price to buy and sell units in a fund. If the difference is 5%, it means that €5 out of every €100 used to buy units is taken off as a charge. As a result, the value of a €100 investment would fall to €95.

<sup>136</sup> Source: Consumer Help IE. Link to the article is [here](#).

- Monthly policy fee - this is usually a fixed amount charged each month, typically ranging from €3 to €6. It is taken either directly from the investment or from the value of a fund.
- Product management fee - this is sometimes charged for ongoing advice from a financial advisor or stockbroker. It may be 1% to 2% of the value of a fund each year.
- Yearly fund management fee - this is a set percentage of the value of an investment fund that is taken by the provider each year to pay for managing the fund and other general costs. It typically ranges from 0.75% to 1.5% of the value of a fund.
- Early encashment charge - this is a fee that may be charged for any money withdrawn in the first few years. Typically, it varies from 1% to 5%. This charge is highest for withdrawals in the first year and reduces every year after that.

#### **Source 4 – (UK) FCA survey of firms providing financial advice?<sup>137</sup>**

The charging structures were very similar across the three advice areas. The most commonly used type of charge was a percentage fee (i.e. a percentage of investable assets advised on). For investable assets of up to £50,000, the majority of firms charged between 1% and 4.5% for initial advice on investments, with a median initial percentage fee of 3%; the percentage fee was lower for higher levels of investable assets. The median percentage fee for ongoing advice on investments was 0.5% for investable assets of £50,000 or less.

#### **Source 5 – (EU) ANALYZING INVESTMENT MANAGEMENT FEES<sup>138</sup>**

##### **Total Expense Ratio by Fund Type and Distribution Channel**

For the five fund types, the asset-weighted average total expense ratios are:

- Equity ~ 1.75% Absolute Return ~ 1.59%
- Bond ~ 1.17% Alternative/Others ~ 1.54%
- Balanced/Asset Allocation ~ 1.42%

Across the four major European distribution channels analysed in an EFAMA survey of October 2011, asset-weighted average total expense ratios were nearly the same:

- Bank ~ 1.50%
- IFA/Advisor ~ 1.50%
- Platform ~ 1.54%
- Insurance ~ 1.53%

#### **Source 5 – (UK) UK retail investing fees stay above 2.5% annually<sup>139</sup>**

The cost of retail investing in Britain remains above 2.5 per cent annually, down just 10 per cent in the three years since the UK imposed sweeping changes to the way financial advisers serve consumers, according to data supplied to the Financial Times.

#### **Source 6 – (EU) European Fund Expenses Are Decreasing in Percentage<sup>140</sup>**

<sup>137</sup> Source: FCA UK. Link to the survey report is [here](#).

<sup>138</sup> Source: EFAMA October 2011. Link to the paper is [here](#).

<sup>139</sup> Source: FT. Link to the article is [here](#).

This study of European investment funds found that the asset-weighted ongoing charge for the full European fund universe is 1.00% in 2016, down from 1.09% in the 2013 study named "Expenses in Nordic Investment Funds in a European Context." The decline is, among other factors, a result of the increasing penetration of clean share classes (without commission fee) but also investors' general increased preference for less expensive funds.

**Source 7 – (UK) Example - M&G Absolute Return Bond Fund**<sup>141</sup>

Ongoing charge 0.86% of assets under management.

Retail investors may switch between other sub-funds of M&G Investment Funds. An entry charge may apply.

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<sup>140</sup> Source: Morningstar study 2016. Link to the report is [here](#).

<sup>141</sup> Source: Key information document on one of the funds by M&G for financial advisors. Link is [here](#).

## ANNEX 10 - LIST OF OTHER FEATURES THAT COULD BE PART OF A REGULATORY STATUTE ESTABLISHING A PEPP

Other important features include rules on costs and fees, the possibility for a guarantee on biometric risk, possible requirements for a depository or investor compensation system.

### Rules on costs and fees

In view of the impact of costs and fees on returns, three options can be envisaged for general costs and charges, excluding possible switching charges that are separately dealt with in section 4.3.1.1:

Policy option	Description
1. Baseline (existing EU sectoral legislation or if absent national legislation)	No requirements on fees and costs.
2. Cap on costs and charges	Establish a cap on costs and charges.
3. Transparency on costs and charges	Establish transparency-requirements for costs and charges inspired by sectoral legislation (e.g. PRIIPS, IDD or IORP II).

In option 1 providers could charge fees and costs at their discretion. This could potentially be attractive from the perspective of developing the supply side for the PEPP product. Providers could reduce their cost base by charging costs and charges to PEPP savers. However, no policy action would be disadvantageous from a consumer protection perspective: risks to overcharging could increase and, as a consequence, PEPP saver returns on the product could be seriously impacted. In particular consumers' organisations during the public consultation highlighted that costs and charges of existing personal pension products are often high, opaque and not fully disclosed, undermining the attractiveness of these products and limiting returns and outcomes at retirement. EIOPA technical advice recommended taking existing transparency based legislation as a starting point, with reference to PRIIPs and while acknowledging that capping costs is not the first-best option, for this product it could be further explored.<sup>142</sup>

A possible solution to the disadvantages of option 1 could be option 2, i.e. a cap on costs and charges based on objective parameters. While the consumer protection is increased and providers would benefit from upfront clarity on maximum costs and charges that could apply, assessing the appropriate level of a pan-European cap applicable to different types of providers would be excessively difficult in light of the varying economic contexts in the Member States. An excessively strict cap would limit the take-up of the PEPP and an excessively lenient cap might not achieve its consumer protection objective.

<sup>142</sup> EIOPA technical advice, p. 35, 53.

Option 3 would allow establishing a level-playing field between providers whilst ensuring consumer protection. Comparative information would be available between different products and incentivise competitive pricing with a risk that providers could still apply high fees in the short term.

Consequently, option 3 is recommended.

### **Guarantee against the biometric risk**

Such guarantee could be considered as an essential feature to ensure consumer protection. However it would entail consequences in terms of potential providers and limit the market to insurers, disadvantaging asset managers and investment firms. Alternatively, the PEPP framework could provide a Member State option; or not cover the biometric risk at all.

<b>Policy option</b>	<b>Description</b>
1. Baseline (existing EU sectoral legislation or if absent national legislation)	No requirements for guarantee against the biometric risk. Member States would determine the appropriate guarantee, if any.
2. Mandatory guarantee on biometric risk	Obligation for all PEPP providers to provide a guarantee against the biometric risk.

Option 1 leaves it up to the providers to offer a guarantee against the biometric risk in their product offer. To addressing concerns expressed by some Member States with regard to minimum consumer protection, Member States could decide at national level to require such a guarantee for death, disability or both and could allow the PEPP to obtain favourable tax treatment.

Option 2 would introduce a mandatory guarantee for all PEPP providers. From a consumer protection perspective, money allocated to a retirement objective is safeguarded against changes in investment value. A disadvantage would be that the provision of PEPPs could be unattractive for those providers, others than insurers and pension funds that cannot ensure a mandatory guarantee against biometric risk.

Option 1 is recommended given the low level of demand from consumer organisations for such guarantee, the establishment of a level playing field between different types of providers and the flexibility for providers to take into account the national criteria for tax incentives if and when such guarantee is offered.

### **Depository, custodian functions and investor protection**

In order to further protect investors, the PEPP framework could require an independent depository function (based on UCITS<sup>143</sup> or IORP II) to avoid fraud or custody risk in the management (or valuation) of assets, as well as to ensure that assets of scheme are not lost in case of bankruptcy of the PEPP provider.

<sup>143</sup> The statute could avoid duplication with other depository obligations when assets are already covered by the UCITS obligation.

This function would come in addition to the risk mitigation contained in the investment options, which imply an obligation on the provider to protect the PEPP saver's capital.

### Other elements of prudential supervision

This section applies to the elements of prudential supervision which are not treated above, such as the solvency regime, supervisory powers, etc.

The PEPP providers would be subject to a prudential supervision regime with the following options:

Policy option	Description
1. Baseline (existing EU sectoral legislation or if absent national legislation)	All PEPP providers including those which are subject to a national but no EU prudential regime could offer a PEPP, subject to their respective prudential regime;
2. PEPP providers subject to their respective current EU regimes	Only providers already subject to an EU prudential regime would be able to offer a PEPP, subject to their respective prudential regime;
3. PEPP providers subject to a new EU regime	A specific prudential regime would be created and apply to all PEPP providers.

Under the baseline scenario, there are some risks of regulatory arbitrage as regards providers not subject to harmonised prudential regimes, undermining the level playing field. In addition, the cross-border development of PEPPs might be hindered due to the patchwork of applicable national and EU regimes for PEPP providers.

In comparison, Option 2 would create a level playing field and prevent regulatory arbitrage as all providers would be subject to at least one EU Rules. Despite the coexistence of distinct EU rules applicable to distinct providers, this option would limit costs whilst offering PEPP savers the protection conferred by the sectoral prudential regimes. This option is hence recommended.

Under Option 3, all providers would be subject to the same EU prudential regime. However, this would create potential incompatibilities with some providers e.g asset managers. A standalone prudential regime risks deterring some providers to enter the market and undermines the take-up of the PEPP.