efama

European Fund and Asset Management Association

EFAMA's comments on the European Commission's proposal for a Regulation on a pan-European personal pension product (PEPP)

Introduction

EFAMA welcomes the European Commission's proposed Regulation for the creation of a pan-European Personal Pension Product (PEPP) that is complementary to and supportive of existing public and occupational pensions. We strongly support the aim of creating a simple, standardised personal pension product that can be passported throughout the EU and believe that the PEPP, with the right conditions, could play an instrumental role in turning the CMU into a success for European consumers and savers.

EFAMA has long argued for the need to take a legislative initiative in this area for a number of reasons:

- The PEPP would contribute to increasing retirement savings across Europe. In turn, this would help provide the capital needed to finance economic growth in the EU through the development and integration of its capital markets. This would make the PEPP a major building block of the Capital Markets Union.

- The PEPP would improve the financial sustainability of pension systems, not least by encouraging Europe's youth to start saving as early as possible. This would harness the power of compounding, which, over a period of 30 to 40 years, is considerable.

- The PEPP would foster an EU Single Market for personal pensions. This would address fragmentation between national markets, which currently prevents cross-border distribution of personal pensions and results in limited competition between providers, higher prices and an absence of portable personal pensions across Member States.

- The PEPP would be of particular interest to individuals who do not have access to occupational pensions, especially self-employed workers. The portability of the PEPP would also make it easier to work across the EU and save in one personal pension product.

- The PEPP would play a big part in encouraging savers to shift some of their savings from bank accounts into a product that would be higher yielding as a result of competition and economies of scale.

EFAMA also welcomes the Commission's recommendation that Member States give PEPPs the most favorable tax treatment available to their national personal pension products.

We note, however, that the PEPP Regulation would likely only produce all of its expected positive effects if the issues raised in this document were addressed.

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Executive Summary

EFAMA's 10 priorities for a PEPP which will work for savers and the CMU:

1. Confirming **life-cycle investment** strategies as a PEPP default option is the single most important issue which will ensure a more competitive pensions market, better choice for investors and, ultimately, will determine whether PEPP and CMU works for European savers.

2. PEPP providers should be able to decide which Member States they are able to offer the **portability** service in.

3. All PEPP providers and distributors should fall under the **same distribution and information requirements, as laid down in the draft PEPP Proposal**, including the same inducement rules.

4. The default investment option and all "alternative" investment options should offer **value-for-money**.

5. PEPPs should be authorised by their **National Competent Authorities**, not by EIOPA.

6. The PEPP Regulation should outline the specific aspects of the PEPP Regulation which can be regulated at national level to avoid any **goldplating**.

7. PEPP's success will depend on whether it is flexible enough to accommodate investors with different needs, wealth, risk profiles and pension benefits and in this respect, we support the Proposal's options regarding **pay-out options**.

8. PEPP savers should be able to **switch** to another PEPP provider more frequently than once every five years.

9. PEPP providers should be allowed to **invest in non-liquid assets and instruments with a long-term economic profile** that are not traded on regulated markets, in line with the "prudent person" rule.

10. It would be more efficient for the PEPP's **Key Information Document** to contain non-country specific information.

Issue 1: Confirming life-cycle investment strategies as a PEPP default option (Article 37)

A game-changer:

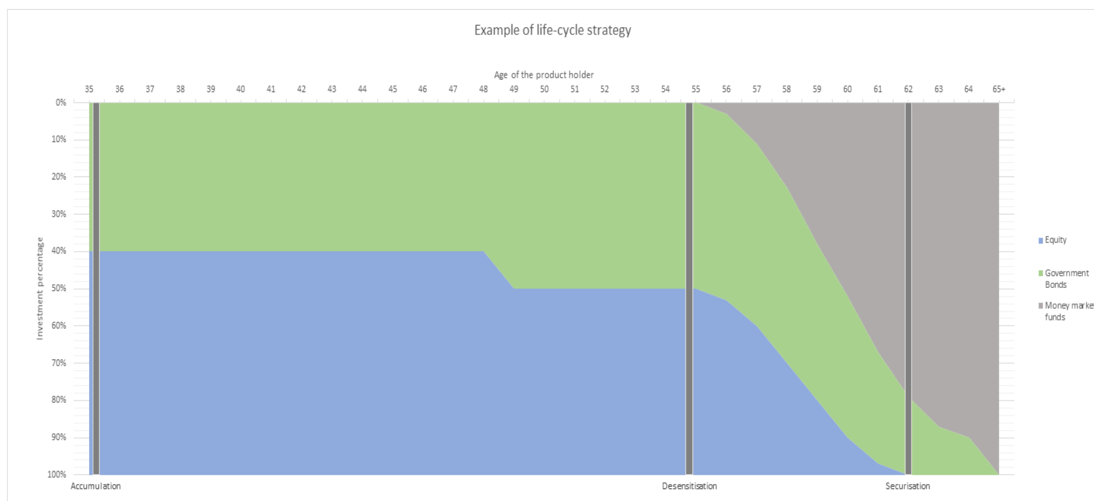
Having life-cycle investment strategies as a PEPP default option is essential – it ensures a more competitive pensions market, better choice for investors and, ultimately, will determine whether PEPP and CMU works for European savers.

As it currently stands, the PEPP Proposal is ambiguous on whether life-cycle investment strategies can be offered as a default option. Whilst Article 37.1 adequately establishes that "*the default investment option shall ensure capital protection for the PEPP saver, on the basis of a risk-mitigation technique that results in a safe investment strategy*", Article 37.2 notes that "*capital protection shall allow the PEPP saver to recoup the capital invested".* Market players and savers need clarity and certainty that life-cycle investment strategies are in the default option.

An obligation to provide a financial guarantee would lead to investment into traditional assets, such as government bonds and bank deposits, leading to relatively low returns, especially in a low interest rate environment. This goes against the CMU's *raison d'être*, to foster investments in equity and increase growth. A financial guarantee would also create a significant barrier to entry into the PEPP market as only some providers would be able to offer such guarantees. Opening up the PEPP market is crucial for competition, choice and value for consumers.

Life-cycle strategies and protecting future retirement income:

Most assets in life-cycle strategies are invested in higher-risk, higher-return assets such as equities for younger scheme members, with a switching mechanism to increase the proportion in fixed-income assets as the planned retirement approaches (see chart below). This ensures return generation for most of the accumulation years, but a reduction in exposure to market volatility shortly before retirement.



There is no doubt that the default option needs to safeguard capital invested by the PEPP saver without neglecting the objective of generating future retirement income. It is precisely because life-cycle strategies manage to link the objective of downside risk protection and upside performance, through the use of robust risk mitigation techniques, that they can be regarded as natural choices for default option in retirement plans.

EIOPA and OECD views on life-cycle strategies:

- EIOPA's advice on the development of an EU Single Market for personal pensions recommended that each PEPP include a default or "core" investment option, and defined the default investment option as "*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."* [1]

- The OECD Working Party on Private Pensions identified elements of good design and public policy, which have been summarised in a roadmap for the good design of defined contribution plan. This roadmap includes the following recommendation:

    - *Establish appropriate default investment strategies, while also providing choice between options with different risk profile and investment horizon. As many members may be unwilling or unable to choose investments, default options need to be carefully designed following the lessons learnt from behavioural economics. But if they wish, people should be allowed to choose the investment strategy best suited for them according to their risk profile and their level of risk tolerance, as well as their different overall pension arrangements.*

    - *Consider establishing default life-cycle investment strategies as a default option to protect people close to retirement against extreme negative outcomes. Life-cycle investment strategies reduce the impact of market risk on the account balance as the member ages. Such a design is consistent with economic rationale and risk attitudes and is therefore well-suited for default strategies.*

[1] See page 650 of the advice: https://eiopa.europa.eu/Publications/Consultations/EIOPA%27s%20advice%20on%20the%20development%20of%20an%20EU%20single%20market%20for%20personal%20pension%20products.pdf.

Issue 2: Portability and compartments (Article 13)

The requirement in the Commission's proposal that each PEPP provider offer national compartments for all Member States would, in EFAMA's view, be a strong deterrent for providers considering entry into the PEPP market. PEPP providers should be able to decide which Member States they are able to offer the portability service in.

The requirement to cover all Member States could have serious consequences on the development of the PEPP market. In small Member States, the vast majority of providers would not be able to offer PEPPs as they do not have the administrative capacity to offer national compartments in all Member States. This would seriously limit PEPPs offerings in Europe and reduce competition. It would also impede smaller PEPP providers from entering the market, as they would be deterred from targeting a smaller number of Member States where, based on various factors (potential demand, spoken language, taxation rules, local presence and specific local knowledge, etc.), it would be realistic for them to set-up.

RESAVER, a defined-contribution occupational pension fund that has been created with the strong support of the European Commission to facilitate researcher mobility in the EEA to allow continuity of pension savings across organisations and/or countries, is currently only available in a very limited number of Member States and the Commission expects only nine countries to be part of this programme by the end of 2018.[2] This experience confirms the need to amend the current draft PEPP proposal to give potential PEPP providers enough flexibility to decide the extent to which they want to provide their PEPPs on a cross-border basis.

This being said, we fully recognise that portability is one of the key features of the PEPP. Given the importance of this objective, we believe that particular attention could be given to the following points.

- Pre-contractual information should clearly specify the Member States where the portability service is made available. This information will foster competition between providers and encourage them to pay attention to the portability service they offer. To enhance this competition, the central public register kept by EIOPA could provide information about the national compartments offered by each PEPP provider.

- Consideration should be given to allowing providers offer the portability service by negotiating cooperation arrangements with providers established in Member States where they do not offer national compartments.

- EIOPA could create an information platform to inform PEPP providers about the national requirements that apply to PEPPs in each Member State, the tax relief granted to PEPPs, as well as the tax requirements – relating to the contribution, accumulation, and decumulation phases – applied to the PEPP. This type of information will reduce the administration costs related to the search for the national rules applied to the PEPP, thereby encouraging a greater number of providers to ensure the portability of their PEPPs.

[2] http://www.resaver.eu/resaver/participating-countries/

Issue 3: Common distribution and information requirements (Articles 18-32)

To ensure the highest level of consumer protection, all PEPP providers and distributors fall under the same distribution and information requirements, as laid down in Chapter IV of the draft Regulation, including the same inducement rules. With that logic in mind, all references to Article 19 (c) in Articles 20, 24, 25 and 26 should be replaced by "PEPP providers and distributors referred to in Article 5(1) and Article 8 of this Regulation".

The application of existing MiFID II and IDD sectorial laws for the distribution of PEPPs could indeed create inherent problems for the marketing of PEPPs. These divergences could create an un-level playing field with different disclosure requirements and different levels of investor protection for PEPP savers depending on whether they subscribe to a PEPP via an insurance provider, an asset manager, a bank or another type of provider. This situation could undermine the overall acceptance of the PEPP as trustworthy pension product.

Applying the same rules would also have the merit of clarifying that all PEPP providers or distributors be allowed to offer the default investment option without advice. Article 26 only refers to PEPP providers or distributors referred to in Article 19(c) as entities that could sell the default option without advice.

With regard specifically to the inducement rules, EFAMA agrees with the Commission's approach laid down in Article 20, assuming it would indeed apply to all PEPP providers. The MiFID rules have indeed the advantage of making a clear distinction between "independent" and "non-independent" advice and stressing the duty placed on distributors to prove a "quality enhancement" of the advice when receiving inducements.

Issue 4: All "alternative" investment options should offer value-for-money (Article 38)

Article 38 (1) provides that PEPP providers may offer up to four "alternative" investment options, and one of them shall be "cost-effective". It is unclear why only this article refers to a cost-effective investment option.

Moreover, EFAMA considers that the concept of "cost-effectiveness" is too narrow because the relevant criteria should not be cost, but rather a fair combination of price and quality delivered to the consumer. For this reason, we suggest referring to the concept of "value-for-money".

Issue 5: PEPP competence for authorisation by EIOPA as supervisory authority (Article 4 (1))

EFAMA believes that PEPPs should be authorised by the national competent authority (NCA) of the PEPP provider. This would avoid putting in place a complex procedure which would inevitably involve duplication of tasks between EIOPA and NCAs.

The proposal that a PEPP be authorised by EIOPA raises a number of concerns:

- It is unclear whether granting EIOPA powers to authorise PEPPs would be more effective than leaving the authorisation process at national level.

- As the PEPP will be subject to certain provisions of laws adopted by Member States, national regulators would need to be involved.

- The fact that Article 6 provides that *"before taking a decision on the application, EIOPA shall consult the competent authority of the applicant"* and that Article 53 provides that "*the competent authority of the PEPP provider shall supervise compliance with this Regulation on an ongoing basis*" confirms that EIOPA would have difficulties in granting authorisation of PEPPs without the support of national competent authorities.

- Given that a number of different national authorities would be involved in light of their specific responsibilities in the supervision of financial services providers, EIOPA would have to conclude memoranda of understanding with a large number of authorities. Overall, this would require to finance a significant increase in the resources of EIOPA.

However, there could be a role for EIOPA in developing common minimum standards on documentation and elements of information to ensure a high level of standardisation and transparency in the conditions for granting authorisation of PEPPs by NCAs.

Issue 6: Matters not regulated by the Regulation (Articles 40 and 51)

There are a number of matters not regulated by the Regulation where Member States may decide to apply different national rules. There is a risk that this would seriously limit PEPP standardisation and create barriers to entry to the PEPP market. In EFAMA's view, this concern could be addressed by outlining the specific aspects of the PEPP Regulation which can be regulated at national level.

Both Article 40 and Article 51 state that the PEPP conditions related to the accumulation and decumulation phases be determined by Member States unless specified in the regulation. It also provides examples of conditions that could be specified by Member States, meaning other conditions may be imposed.

Issue 7: Choice of pay-out options

EFAMA fully supports the provision in Article 52(1) that "*PEPP providers may make available to PEPP savers one or more of the following forms of out-payments: (a) annuities; (b) lump sum; (d) drawdown payments; (d) combinations of the above forms."*

The PEPP's success will depend on whether it is flexible enough to accommodate investors with different needs, wealth, risk profiles and pension benefits.

Life-annuities (series of payments at fixed intervals, paid during the lifetime of the beneficiary) are not necessarily relevant for all individuals, especially in Member States where public pension regimes are able to provide an adequate standard of living in retirement. Likewise, a life-annuity may not be interesting for pensioners who only invest a small amount of capital in the PEPP because the level of the annuity would be too small compared to the cost incurred by this type of pay-out option. Depending on individual circumstances, retirees may prefer to choose another form of out-payments for the decumulation phase.

EFAMA also supports the proposal in Article 52.2 that PEPP savers may change their decision during the accumulation phase. Though, in practice PEPP savers will most likely select a payout option at the very end of the accumulation phase.

Issue 8: Switching PEPP providers (Article 45)

The Proposal would allow a PEPP saver to switch providers no more frequently than once every 5 years. The 5-year limit is, in EFAMA's view, too restrictive.

Applying restrictions on switching of PEPP provider and/or investment options could be a deterrent to savers when considering the PEPP as their savings product for retirement. Customers should be able to switch to another PEPP provider and/or investment options without restrictions, by evaluating and taking into account their individual needs and preferences.

We also believe that applying these restrictions could have negative effects on product development and competition, essential for better customer experience and outcomes (for example benefiting from more choice, better quality and more cost effective products).

We do recognise that PEPP providers investing in non-liquid assets may impose restrictions on switching within certain periods. However, PEPP providers investing into diversified, liquid and listed securities should not impose provider and/or investment switching restrictions to PEPP savers.

Issue 9: Investment rules (Article 33)

EFAMA fully supports the proposal that PEPP providers invest in accordance with the "prudent person", as per Article 33 (1). However the provision that the proposed rules "*apply only to the extent that there is no more stringent provision in the relevant sectorial legislation applicable to the PEPP provider*" is unclear.

We are concerned that this requirement would force UCITS managers to apply the UCITS product rules, which are justified in large part by the need to provide daily liquidity to UCITS share/unit holders.

As the PEPP proposal aims to channel savings towards long-term investments, PEPP providers should be allowed to invest in non-liquid assets and instruments with a long-term economic profile that are not traded on regulated markets, in line with the prudent person rule. We therefore believe that Article 33 (2) should allow, but not require, providers to follow more stringent rules.

Issue 10: PEPP Key Information Document (Article 23)

It would be more efficient for the PEPP KID to contain non-country specific information, with the understanding that the PEPP provider disclose country-specific information in a separate document to be delivered to the PEPP savers residing in the Member States concerned.

Other adjustments need to be made in the Proposal regarding the PEPP's Key Information Document:

- There should be a reference to the "investment policy related to environmental, social and governance factors", when applicable, and not to the "performance of the investment policy" of ESG.
- Only PEPP providers using their balance sheets to offer guarantees should provide reports on their solvency.
- PEPP providers should also provide information about the safeguard mechanisms used to protect the PEPP assets which are not held on their balance sheets, e.g. depositary arrangements.

Issue 11: PEPP Benefit Statement (Article 28)

When it comes to the benefit projections, it should be clarified that "estimated" scenarios are being referred to. This would avoid any confusion and risk of litigation regarding this aspect of the benefit statement. PEPP providers should be allowed to use a disclaimer in this regard.

To reduce costs, we also believe that PEPP providers should be allowed to offer PEPP savers the possibility of receiving the PEPP Benefit Statement in digital form.

Issue 12: Eligible PEPP providers (Article 5(1))

EFAMA shares the Commission's view that providers authorised under the CRD IV, Solvency II, IORP, MiFID, UCITS and AIFM Directives be able to apply for authorisation of a PEPP. This would avoid creating additional regulatory requirements for these providers.

However, this provision means that all the entities currently authorised, regulated and supervised as personal pension product providers at domestic level would be excluded from the provision and distribution of the PEPP. This would be the case, in particular, for the Spanish Management Companies of Pension Funds ("Entidades Gestoras de Fondos de Pensiones"), which have a long tradition of managing personal pension assets in Spain.

In EFAMA's view, it would be useful to assess under which conditions PEPP providers not authorised under EU financial services legislation could have the possibility of providing PEPPs.

Issue 13: Tax treatment of PEPPs

EFAMA shares the Commission's views that the tax treatment applicable to personal pension products in general and to the PEPP, in particular, is a crucial element for its promotion and its implementation across Member States. Giving PEPPs the most favorable tax treatment available to national personal pension products is a necessary condition for the success of the PEPP.

In this respect, EFAMA welcomes the Recommendation issued by the Commission on the tax treatment of personal pension products, including the PEPP, on 29 June 2017, which encouraged Member States to apply to individuals who qualify as PEPP savers "*the same tax relief as the one granted to national PPPs, once*

these PEPPs are launched on the personal pension market, even in those cases where the PEPPs product features do not match all the national criteria required by the Member State to grant tax relief to PPPs." EFAMA also fully supports the view that "*where Member States have more than one type of PPP, they are encouraged to give PEPPs the most favourable tax treatment available to their PPPs*."

EFAMA would encourage the European authorities to consider further steps to reach the objective of the most favourable treatment from the outset. This could be done, for instance, through the development of minimum standards for the tax treatment of contributions applicable in the accumulation phase, and the consistent taxation of PEPP retirement benefits across the EU.

It would also be helpful if EIOPA would keep track of and publish the tax rules applied to PEPPs in each Member State. This would provide a central source of information for individual and PEPP providers, which would simplify the administration of the national compartments and reduce costs.

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