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THE PAN EUROPEAN PERSONAL PENSION PRODUCT (PEPP)

A golden opportunity to bridge the pensions gap

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CONTENTS

EXECUTIVE SUMMARY

How will the PEPP benefit the EU?

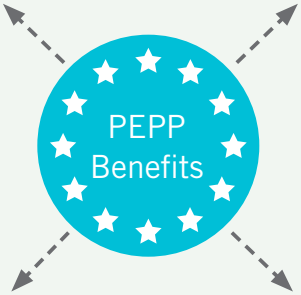
The PEPP offers a once in a generation opportunity to reshape the face of European pensions provision and address Europe's pensions savings gap. The PEPP will bring benefits for ordinary citizens, EU Member States and employers. Europe's investment funds industry can play a key role in facilitating the PEPP and making it a reality. Irish Funds is keen to share its views on the opportunities the PEPP can offer and supports the work that the European Fund and Asset Management Association (EFAMA) has already conducted in this area[1].

Ordinary citizens benefit from:

- An additional form of retirement savings for employees who are worried that existing state and employer pensions will not provide sufficient income in retirement
- A pension that moves with them as circumstances change, e.g. if they change employer, move country or potentially even if they set up their own business
- Greater choice and increased value for money through enhanced competition

Member States benefit from:

- The development of a robust private pension regime, complementing and supporting the long term sustainability of existing state and occupational pensions
- A way to offer pensions provision to the increasing numbers of self-employed
- The development of a regular pool of patient long term capital ready to be invested in the economy, strengthening the foundations of Capital Markets Union
- A scalable solution to a common problem



Employers benefit from:

- An especially valuable offering for SMEs who are not covered by collective pension arrangements and as a result find the administrative costs of existing occupational schemes prohibitive
- An easy to use private pension option as an additional employee benefit

The funds industry can help by:

- Offering a simple, flexible and portable retirement savings vehicle to complement existing pension provision
- Providing decades of experience of managing the types of investments appropriate for use in pensions, such as default lifestyle funds
- Leveraging the existing funds industry experience in providing cross-border investment products such as UCITS
- Offering economies of scale through cross-border platforms

[1] See "Efama reiterates its support for a Pan-European Personal Pension product", May 2017

EXECUTIVE SUMMARY

Key enabling factors

There are a number of enabling factors that are fundamental to the PEPP's success. These include:

- **Simplicity and ease of use**: The PEPP must be simple and easy for consumers to understand and use while also meeting their changing work and life circumstances. Such an approach needs to manifest itself through the key features of the product, its distribution and its usability at the Member State level, as well as its administration on a national and cross-border basis.

- **Trust**: In order to build trust in the PEPP brand, the PEPP needs to be subject to high standards of consumer protection and governance requirements.

- **Standardisation**: There needs to be a sufficient level of standardisation of product features and disclosures to create a truly pan-European personal pension product that can achieve cross-border economies of scale and develop a PEPP brand awareness.

- **Works with existing EU regulatory regimes**: We expect the PEPP to be sold through a variety of distribution channels and we need to ensure that different sectoral EU distribution rules (e.g. IDD and MiFID II) do not inadvertently restrict sales of the PEPP, as well as minimising barriers at the level of individual Member States.

- **Fits with national pensions and tax frameworks**: The PEPP will need to qualify for national tax incentives for pensions savings and to be afforded at least the same local tax reliefs that equivalent local pension products benefit from.

- **Consumer education and awareness raising**: Financial education will be required for consumers to take greater responsibility for saving for their retirement and to be in a position to make informed saving and investment decisions. Consumers will need to be able to access user friendly information and educational tools on the PEPP which should be consistent across the EU and help to develop the PEPP brand. Disclosures need to be consumer friendly.

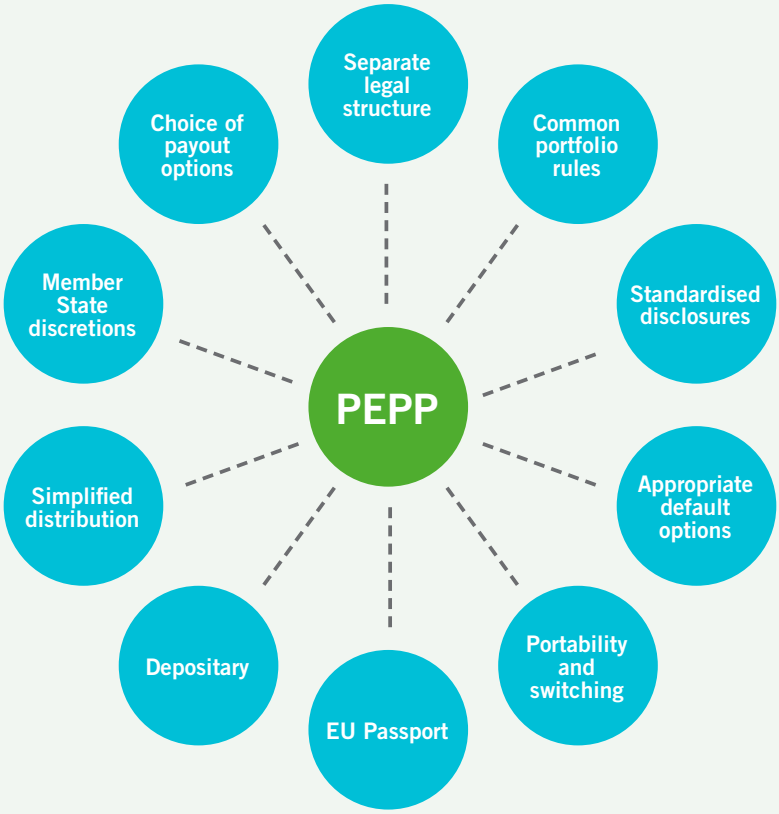
- **Saving incentives**: Consumers also need to be incentivised to take up saving for their pensions through actions such as auto-enrolment, tax treatment and savings incentives.

- **Build on the UCITS experience**: The success of UCITS as a cross-border retail fund product serves as a model for the PEPP. Several aspects of the PEPP can be modelled on the UCITS regime. Certain aspects of the UCITS regime can also be improved on or adapted in places to take account of the specific needs of a PEPP.

EXECUTIVE SUMMARY

Proposed key features of the PEPP

Taking the key enabling factors into account, the PEPP should include the following features:



- **A separate legal structure** to allow for a strong governance framework and maintenance of separate assets and liabilities. The structure should allow for different wrappers, e.g. via an insurance contract.
- **Common portfolio rules**: These should cover eligible assets, investment diversification and concentration limits that could draw on the UCITS framework but provide for a longer term investing horizon to include less liquid assets in the portfolio. As a pension product, there should be no, or very limited, possibilities to withdraw assets before retirement.
- **Standardised disclosures:** Standardised disclosures will be key in the areas of expected retirement income, performance and risk, costs and ongoing member communications and reporting.

EXECUTIVE SUMMARY

- **Appropriate default options**: Some savers may not wish to make any investment decisions, meaning a well-constructed default investment option should be included. This may include, for example, a market-linked savings objective combined with life cycle risk reduction as the saver approaches retirement. Capital guarantees should be possible but not mandated. Providers could offer additional strategies to reflect saver demands such as explicit environmental, social and governance (ESG) criteria.

- **Portability and switching:** While a pension is a long-term investment by definition, a consumer should be able to switch to another PEPP, taking into account their individual needs and preferences. Such switching should be possible in line with the trading frequency of the underlying investments. A consumer should also be able to take their PEPP with them if they change employment and/or move to another Member State. Such portability should be facilitated both within and between Member States.

- **Choice of payout options:** As the PEPP is a pension product, all PEPPs should offer at least one payout option on retirement – consumers could choose between receiving guaranteed or variable income or being able to access all or part of the accumulated capital as a lump sum on retirement.

- **EU Passport:** The PEPP should benefit from the principle of the EU Passport under a freedom of services basis. Once authorised in one EU Member State, it should be possible to market a PEPP in other EU Member States.

- **Depositary:** Assets should be entrusted to an independent PEPP depositary based on the UCITS and AIFMD model to ensure appropriate oversight and safekeeping and prevent exposure of the consumer to any credit or insolvency risk of the PEPP provider, except where PEPP assets are held on the balance sheet of an institution subject to prudential regulation.

- **Simplified distribution:** Distribution should be possible through a variety of channels, including advised and online. Enabling access to support and advice on pensions within the workplace is likely to be important and employers need to be encouraged to facilitate the sale of a PEPP without placing an undue burden on them. Distribution rules should be simplified based on the UCITS experience and underpinned by appropriate guidance and standards.

- **Member State discretions:** Member States should ensure that the PEPP can be provided on equal terms with local personal pension products but certain aspects are best left to Member States to provide for, given the diversity of national legal, regulatory and taxation systems. Aspects that are best dealt with at the Member State level include retirement age, the pay-out options and tax treatment. However, in order to be successful, it is vital that the PEPP is afforded at least the same local tax reliefs that equivalent local pension products benefit from.

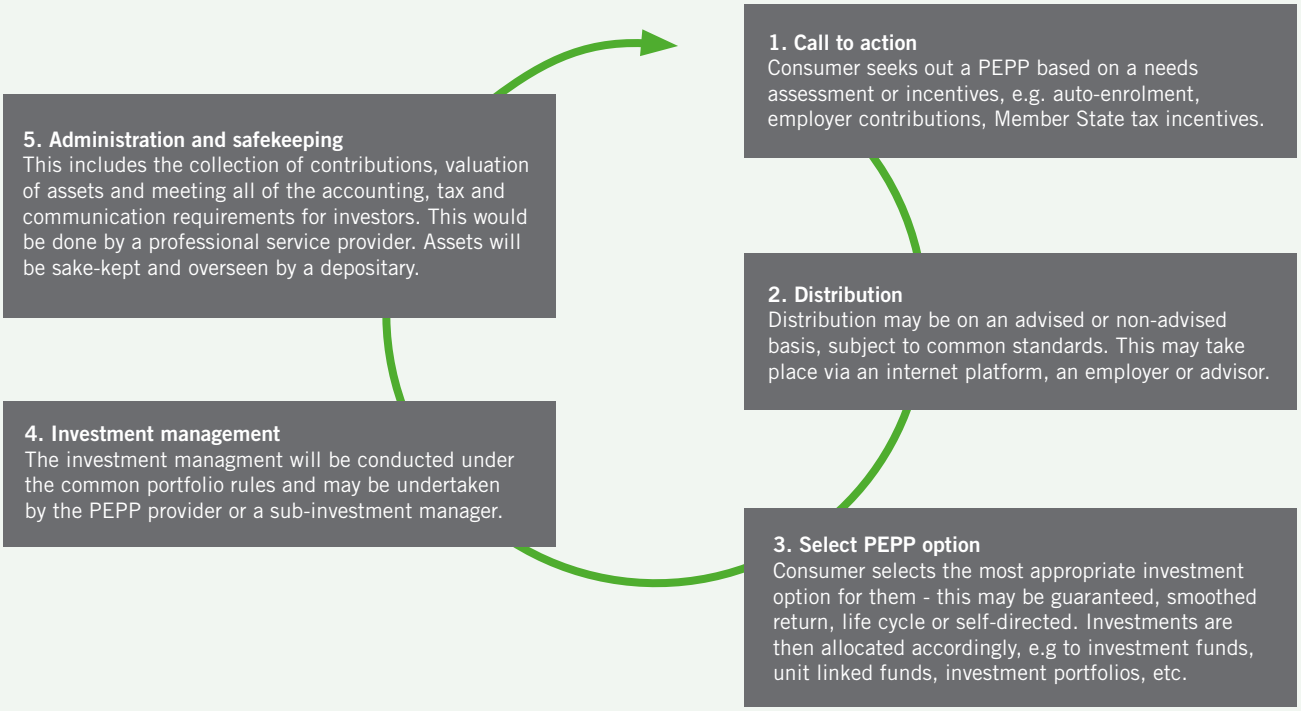
EXECUTIVE SUMMARY

How will the PEPP work?

Raising consumer awareness, educating and incentivising consumers to take action to meet their retirement needs should form a key part of the initiative. Consumers will be likely to invest in the PEPP through a variety of distribution channels which may include online platforms, their financial advisor or their employer and ensuring appropriate and workable distribution standards through these various channels will be key. Consumers will select the most appropriate investment option to meet their needs. Consumers may choose a default option from those offered by different providers or instead choose to take more or less investment risk or because they want a different solution tailored to meet ESG or religious investing requirements. The PEPP options will be managed either by the PEPP provider or sub-delegated to an investment manager. Such management delegates may include fund managers of UCITS and AIFs or such managers may develop their own PEPP offerings and also become involved in distribution directly.

It is envisaged that asset managers, insurance companies, banks and Institutions for Organisational Retirement Provision (IORPs) would all qualify as PEPP providers and operate under the conditions set out under the PEPP framework. While the European Insurance and Occupational Pensions Authority (EIOPA) would set appropriate standards for the operation of the PEPP and would be regulated by the relevant pensions regulator, the PEPP providers would remain subject to regulatory authorisation and supervision in accordance with EU legislation in their respective sectors.

The PEPP will need to be administered and this should be undertaken by a professional administrator, while assets would be safe-kept by a professional depositary.



THE CHALLENGES FACING EUROPEAN CITIZENS SAVING FOR RETIREMENT AND WHY THE TIME IS RIGHT FOR THE PEPP

Demographics

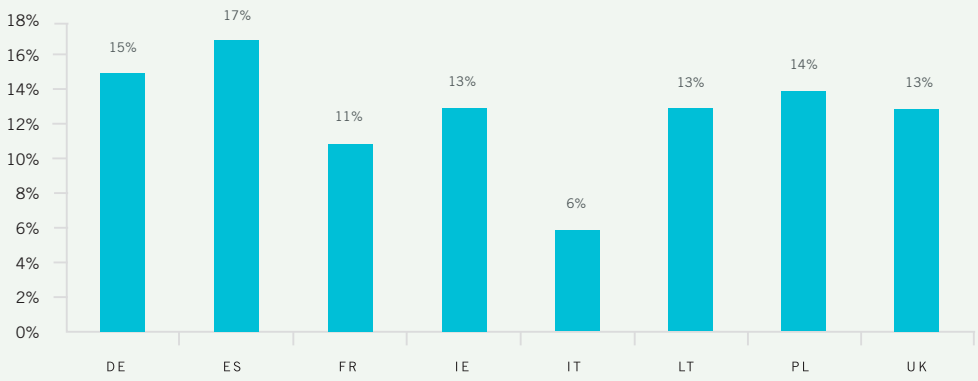
Europe's population is aging rapidly as life expectancy has increased and birth rates have fallen. The share of the EU's population over 65 years of age is projected to rise to 27% by 2040 (from 18% today), while the old-age dependency ratio is projected to climb to over 50% by 2060 (from 28% today)[2]. This implies that the EU would move from having approximately four working-age people for every person aged over 65 years to having two working age people. As the post-war 'baby-boom' generation reaches retirement, these trends have already put pressure on Europe's existing public and occupational pension systems. The gap between projected pension provision and the actual required level of pension cover in Europe is estimated at around €2 trillion a year for the period 2017 to 2057, equivalent to around 13% of the EU's GDP.[3]

THE PENSIONS SAVINGS GAP IN EUROPE IS ESTIMATED AT AROUND €2 TRILLION A YEAR FOR THE PERIOD 2017 TO 2057, EQUIVALENT TO AROUND 13% OF THE EU'S GDP.

Without action, swelling pension liabilities will absorb more and more of Europe's economic output and ultimately, dampen growth and investment prospects. As the proportion of the population that is of working age shrinks, it will not be feasible to bridge the 'pensions gap' through increased taxation without imposing an excessive intergenerational burden. Furthermore, the way we work is changing. An increasingly mobile labour force needs to access more flexible ways of saving for retirement than are typically offered in many Member States. All this increasingly puts the onus on individuals to take more ownership for saving and investing for their retirement. Government policy needs to encourage citizens to prepare for retirement by providing them with a comprehensive retirement savings package through a combination of state, occupational and personal pensions backed up by information and tools on how to save and invest throughout one's working life. The concept of a PEPP could provide a golden opportunity to help bridge the pensions gap.

INDIVIDUALS WILL NEED TO TAKE MORE OWNERSHIP FOR SAVING AND INVESTING FOR THEIR RETIREMENT.

Annual pensions savings gap as % of 2016 GDP



SOURCE: Mind the Gap, Quantifying Europe's Pension Gap, Aviva, September 2016.

[2] Source: "The 2015 Ageing Report, Underlying Assumptions and Projection Methodologies", European Commission, 2014

[3] Source: "Mind the Gap, Quantifying Europe's Pension Gap", Aviva, September 2016

THE CHALLENGES FACING EUROPEAN CITIZENS SAVING FOR RETIREMENT AND WHY THE TIME IS RIGHT FOR THE PEPP

Where the PEPP fits into the current pensions system

European pension provision is broadly categorised into three 'pillars':

- **'Pillar 1'** refers to state run social security which provides for a basic level of income in retirement. Given demographic and financial pressures Pillar 1 is unlikely to provide for an appropriate level of replacement income in retirement for future generations.

- **'Pillar 2'** refers to occupational pensions schemes. Defined Benefit (DB) occupational schemes that provide a set level of pension cover based on an employee's income have become increasingly strained in recent years due to expanding liabilities and the low yield environment. Newer employees have been moved to Defined Contribution (DC) schemes, where only the contribution level is fixed, with DB schemes now a rarity for new hires. In fact, DB pension funds may be forced to cut benefits "significantly" in the long term due to ultra-low interest rates, according to the IMF[4]. There is a cost to running an occupational scheme and employees working in smaller enterprises may not have access to such schemes. Today, workers also change jobs far more frequently than in previous generations meaning that occupational pension cover can be fragmented or non-existent. Changing work patterns also point to an increasing trend towards self-employment without the availability of a Pillar 2 employment-based scheme.

- **'Pillar 3'** refers to personal savings and investment plans where individuals take the initiative to save for their retirement. With insufficient levels of Pillar 1 and 2 cover in many cases, the focus needs to be on the growth of attractive, scalable Pillar 3 solutions that can provide an adequate complementary income for today's workers. We show case studies on the next page on how the PEPP could help different fictional individuals meet their retirement income goals.

The pensions situation in Europe remains unsatisfactory despite several countries having introduced auto-enrolment schemes to ensure that every worker is contributing to a pension, as well as the development of successful national personal pension product frameworks and associated tax incentives in some EU Member States. Changing work patterns and increased cross-border mobility also mean that existing pension products lack the flexibility that many consumers require. Workers increasingly move between employers and may switch from being employed to self-employed and back again. Younger workers may move between employment and study and may need to be able to halt contributions. Increased longevity and better health among older workers will blur the line between work and retirement. These trends, combined with technological innovation are likely to lead to a move away from linear work patterns and an increase in the number of self-employed. Consumers need a pension solution that can facilitate these changing work and life circumstances and empowers them to take control of their retirement planning.

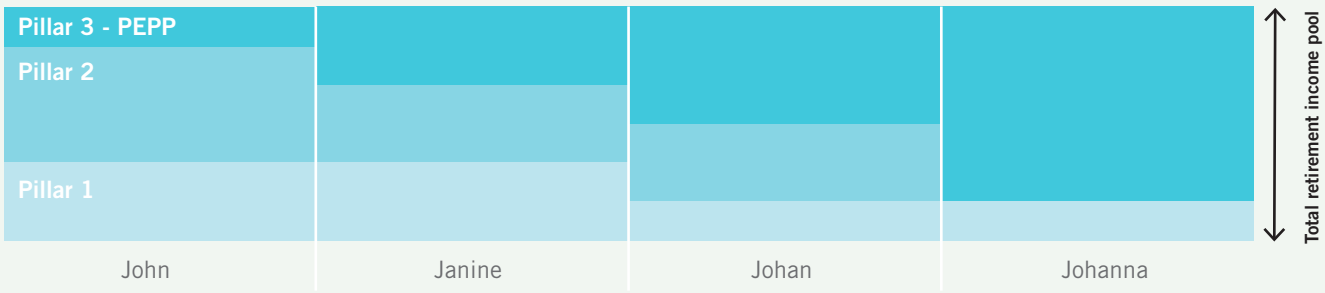
While much has been done at the EU level to develop cross-border availability of financial products and services, pension provision remains almost entirely structured along national lines. A harmonised EU framework for personal pension provision could reduce pension costs and increase competition by increasing greater efficiencies and economies of scale through cross-border platforms.

> CHANGING WORK PATTERNS AND INCREASED CROSS-BORDER MOBILITY MEAN THAT EXISTING PENSION PRODUCTS LACK THE FLEXIBILITY THAT MANY CONSUMERS REQUIRE.

[4] Source: Chapter 2 – "Low Growth, Low Interest Rates and Financial Intermediation", IMF's Global Financial Stability Report, April 2017.

THE CHALLENGES FACING EUROPEAN CITIZENS SAVING FOR RETIREMENT AND WHY THE TIME IS RIGHT FOR THE PEPP

Case studies: Opportunities for the PEPP to complement existing entitlements



John expects high levels of retirement income from Pillar 1 and 2 but is worried whether levels of benefits will stay the same given low interest rates. He would like to save a bit more into a PEPP just to be sure, especially as he is thinking of moving to another EU Member State.

Janine has good state coverage. Her occupational cover is lower than she would like as she previously had to take time off for ill health. In planning for her target retirement date, Janine calculates that she will not have quite enough to live on. Saving into a PEPP gives her the additional flexibility she needs.

Johan has a lower level of state and occupational pension entitlement as a result of a period of unemployment and self-employment without cover while working abroad. Combined state and occupational pension cover will not give him an adequate retirement income. He now has extra money to save and has the chance to catch up by saving into a PEPP.

Joanna is self-employed and can expect a minimal state pension. By saving into a PEPP she has the chance of reaching the retirement income she needs.

CREATING A PEPP FOR SUCCESS

In order for the PEPP to succeed several aspects need to be carefully considered and include:

- switching and portability;
- crafting the investment and pay out options; and
- the legal and regulatory framework.

Switching and portability

To encourage competition between providers, consumers should have the ability to switch PEPP provider as and when they choose without having to pay significant exit fees, which generally damage competition and are not in the consumer interest. The cost of switching should be limited to the dealing costs involved in making that switch. The ability to switch between providers should, however, reflect the liquidity profile of the underlying assets of the PEPP.

Portability should be facilitated both within and between Member States. Consumers should be able to take their PEPP with them if they change employer or if they move to another Member State. Consequently, portability rules between Member States should be regulated at the EU level and switching between Member States should not incur transfer taxes.

Crafting the investment options

In terms of the investment options available, the PEPP must be sufficiently flexible to cater for differing consumer needs and risk/return profiles. Some consumers may not wish to make any investment decisions themselves, irrespective of where they are positioned on the work or life cycle spectrum. These may include consumers in the early accumulation stages where the single saving objective is to maximise long-term wealth, to those at the other end of the spectrum where the delivery of regular income in retirement is the key objective. The PEPP therefore needs to offer a well-structured default investment option.

The standard default investment options which the PEPP could offer include:

1. Life Cycle Strategy Products;
2. Smoothed Return Products; and
3. Guaranteed Products.

Life Cycle Strategy Products

Life cycle strategy products shift the portfolio into low risk investments as consumers approach retirement. These products adjust the asset allocation of a portfolio in accordance with the consumer's term of retirement and are an effective means of balancing risk and reward. The precise design of these strategies depends upon the form in which benefits can be taken on retirement. Life cycle strategies are often delivered through target date funds, which are relatively easy to manage, communicate and adapt as individual circumstances change.

Smoothed Return Products

Products which offer smoothed returns provide consumers with long-term returns which are delivered in a predictable and stable way, while protecting consumers from short-term market volatility and uncertainty and can provide an attractive default offering.

Guaranteed Products

While guaranteed products offer consumers peace of mind by ensuring a minimum guaranteed return irrespective of how markets perform, they do come at a cost. A view exists that for those

CREATING A PEPP FOR SUCCESS

who save over long periods of time, the implicit and explicit cost of guarantees outweigh their relative benefit. This is especially relevant for supplementary savings vehicles such as the PEPP as it is likely to complement other sources of guaranteed income. In addition, guaranteed products can restrict flexibility by only maturing on fixed dates which could be a challenge for many consumers as they move towards more flexible retirement patterns.

Beyond the default – tailored investment options

While the default investment option could provide simplicity and limited risk to the majority of consumers, some consumers may prefer to choose a different investment strategy to reflect a different tolerance to risk or demand for an investment strategy which explicitly reflects ESG or religious criteria. PEPP providers should also be able to cater for demands in this space provided the strategy in question fits within the overall investment rules.

All PEPP products should be permitted to allocate a portion of their portfolios to long-term, less liquid assets. This would be consistent with the long-term nature of saving to retirement as well as generating funding for longer term investment projects identified as one of the cornerstones of CMU (e.g. funding of infrastructure, real estate and SMEs).

The extent to which a PEPP may have exposure to less liquid assets may depend on the nature of the PEPP product itself, and the extent to which consumers have the ability to switch between PEPP providers and/or PEPP products or to switch investment options within a PEPP.

Transitioning to the payout phase

PEPP providers will need to consider how they plan to support consumers into retirement. They will need to consider how to construct the portfolio in the pre-retirement phase to prepare for retirement so they can meet consumer calls for capital draw down or income generation through retirement. Where cash benefits are provided, then allocating to stable capital products as retirement approaches will be favoured. The provision of a guaranteed income product such as an annuity may be best matched by a transition to longer term fixed income investments. Variable income products may favour a more diversified investment approach which allows continued exposure to a level of ongoing capital growth through retirement.

ALL PEPP PRODUCTS SHOULD BE PERMITTED TO ALLOCATE A PORTION OF THEIR PORTFOLIOS TO LONG-TERM, LESS LIQUID ASSETS.

Legal and regulatory framework

In designing a legal and regulatory framework for the PEPP, much can be taken from the UCITS experience and the features which have made it a true cross-border European retail financial product. Leveraging existing regulatory infrastructure should minimise compliance risks for PEPP providers within the asset management industry. Barriers which exist when selling UCITS on a cross-border basis should also be addressed to avoid similar barriers impeding the cross-border distribution of the PEPP (see "Lessons learned from operating UCITS funds on a cross-border basis").

Potential PEPP providers could include asset managers, insurance companies, banks and IORPs and would be subject to regulatory authorisation and supervision in accordance with EU legislation in their respective sectors. In this section we focus on the key features of the UCITS framework which have contributed to its success and which could be applied to the PEPP offered by asset managers. These include:

- **Legal entity:** The PEPP product would be a separate legal structure regulated by the local supervisory authority, as would those entities providing services to it, e.g. the administrator and depositary. This would allow for strong rules around governance and oversight.

CREATING A PEPP FOR SUCCESS

- **Investments**: The PEPP framework would adopt simple investment restrictions, limiting product proliferation and avoiding undue investor confusion. The range of eligible assets should be broader than under the UCITS Directive to allow for long-term investing in accordance with the goals of CMU. Common investment restrictions, including diversification and concentration limits, would facilitate the cross-border offering of the PEPP.

- **Asset ownership**: Assets acquired on behalf of consumers would be held in a custody account (protected by a depositary regime designed to ensure oversight and safe-keeping of those assets) and not on the relevant asset manager's balance sheet. This would ensure that consumers are not exposed to any credit or solvency risk of the PEPP provider. This asset segregation regime would be a key difference from other potential providers such as insurers where the PEPP is likely to sit on their balance sheets and where consumers would benefit from equivalent protection under sectoral prudential capital and solvency rules.

- **Accounting and valuation:** Subscription would occur on a regular basis at the Net Asset Value (NAV). Existing asset management experience of calculating NAV, preparing reports and financial statements and maintaining records could be leveraged.

- **Switching:** The PEPP is a long-term investment product. A PEPP holding less liquid assets should not therefore be required to offer frequent opportunities to switch or transfer assets between providers. However, this should not prevent a PEPP holding only liquid assets from being able to offer more frequent opportunities to switch. Mechanisms relating to notice of switching periods could be built into the legislative framework governing the PEPP.

- **Passport:** PEPP providers would be able to market their PEPPs throughout the EU, once authorised in one EU Member State. Passporting will enable cross-border distribution, economies of scale and lower costs.

PEPP PROVIDERS WOULD BE ABLE TO MARKET THEIR PEPPS THROUGHOUT THE EU, ONCE AUTHORISED IN ONE EU MEMBER STATE.

CONSUMER AWARENESS AND EDUCATION

The marketing of the PEPP at Member State level will be essential to its success. The PEPP will need to provide individual savers with a compelling set of reasons to use it either as a core savings solution or as a complement to existing retirement savings. It is critical in this context that consumers are supported by:

- consistent government policies and effective incentives to save, such as auto-enrolment[5] (especially by SMEs) and an easy to understand explanation of available tax reliefs;
- tools such as national pensions dashboards which allow savers to see how the PEPP, as a complementary Pillar 3 option, can help make up any shortfall in retirement income from existing Pillar 1 and Pillar 2 entitlements;
- well-designed, transparent products and comprehensive advice and guidance to empower consumer participation provided by product manufacturers and advisors; and
- engagement from employers who will continue to be a key interface between consumers and pensions, especially in jurisdictions where employers are able to contribute to personal pensions (e.g. through matching contributions).

We have identified three key areas that will facilitate the use of the PEPP:

1. branding and ease of use;
2. effective communication and transparency; and
3. distribution and access to advice and guidance.

Branding and ease of use

Research indicates that consumers find pensions both dull and emotive - dull because they are seen as complex and hard work to understand; emotive because ultimately they are about future financial security[6]. Effective planning by individuals underpins a successful retirement strategy but frequently the decision-making process can be excessively complex which all too often results in inertia, with consumers leaving their savings in cash. In addition, while there is apparent understanding that money in a pension is money invested, many consumers are still surprised that the risks associated with pensions are the same as those associated with investing.

All of this reinforces the need for Member States to integrate the PEPP into national savings strategies. Consumers need engaging communications on how the PEPP can assist in meeting their long-term savings needs by both government and industry and how it can be held in conjunction with other products designed for short-term savings or to provide financial protection.

More specifically, Member States, industry and consumer bodies will need to clarify how the PEPP sits alongside and complements existing Pillar 1 and Pillar 2 entitlements. This may involve communicating difficult realities to citizens that the existing level of pension provision may not generate the level of retirement income individuals expect. Many people, especially if they change careers during their lifetime, will become members of several pension schemes with different product features. The result is often confusion as to what can be expected from one scheme as opposed to another.

In some jurisdictions the PEPP could be included as part of initiatives to put in place compulsory retirement savings (e.g. by way of automatic enrolment with an opt-out). In these cases, it is key that the PEPP offers a well-designed default investment option as discussed earlier. Coherently combined, tax relief and auto-enrolment can together represent a set of powerful incentives for individuals to save for the long term.

It is fundamental that the initial decision-making process in relation to a PEPP is kept as simple as possible. Once that initial, often emotive, decision has been made to save in a PEPP, the next stage of choosing a PEPP product also needs to remain a straightforward process.

MEMBER STATES NEED TO INTEGRATE THE PEPP INTO THEIR NATIONAL SAVINGS STRATEGIES AND ENGAGE CONSUMERS ON HOW IT CAN MEET THEIR LONG-TERM NEEDS.

[5] For example, the Australian experience of MySuper funds allows employees to ask their employers to direct their mandatory contributions to a fund of their choice.
[6] See "Improving consumer confidence in saving for retirement", National Employment Savings Trust (NEST), 2014

CONSUMER AWARENESS AND EDUCATION

Effective communication and transparency

While transparency on costs, risk and probable performance of the PEPP are critical, in isolation these elements are not sufficient to constitute effective communication. Smart communications with consumers need to be carefully framed to make a difference to both comprehension and behaviour. Many people may start reading pensions communications with suspicion. Communications therefore will need to do more than inform a hypothetical reasonable consumer with pure facts and figures but will need to be designed to reassure the sceptical or worried consumer. Information on pensions needs to be accessible and to be framed in language consumers use such as "What happens to my money?" and "What can I expect to get when I retire?". This type of language should reassure consumers that PEPP providers have their interests in mind and are managing their money responsibly.

Within this wider framework, there are a number of key areas of disclosure which ought to be focused on, such as performance and risk, likely retirement income and costs.

Performance and risk

In an asset management PEPP, one of the specific communication challenges will be communicating the benefits of investing long-term in investment markets. Disclosure standards should provide consumers with a realistic sense of potential long-term returns, while putting the risks of short-term volatility into context. This could mean that rather than providing a simple risk indicator, it may be more effective to set out how downside risk is managed or set out the probability of meeting a given target income on retirement. Overall, the effectiveness of communication should be judged by whether it is conducive to building confidence and creating a dialogue with savers.

Likely retirement income

Research shows that consumers typically underestimate both their expected longevity and the amount of income a given capital sum will deliver[7]. Accordingly, one of the most important elements to disclose to consumers on an ongoing basis is the likely level of retirement income an individual can expect on a given retirement date using standard case studies or income calculators. Increased engagement from individuals is likely to occur when consumers understand what makes up their pension pot and that their expected income is driven by a number of factors which may vary such as the level of their contributions, any supplementary contributions from employers and the length of time they save.

However, to be truly effective, these tools would also benefit from being linked to national pensions dashboards illustrating how the PEPP as a Pillar 3 product supplements other expected retirement income under a Pillar 1 and Pillar 2 scheme/plan. In this way consumers can see whether or not they are likely to have a retirement income shortfall and how the PEPP can contribute to meeting this shortfall.

Costs

The PEPP should adopt a standardised presentation of all costs (investment, administration and advice) to allow consumers to compare costs of different PEPPs on a uniform basis and make informed decisions. At EU level, there are a number of separate regulations and directives with differing requirements on cost disclosure in the retail product arena. Nevertheless, we consider it critical that investors are provided with cost disclosures that are sufficiently simple to be helpful. These disclosures need to be accurate, meaningful, objective and actionable, enabling the comparison of PEPP costs and charges.

INFORMATION ON PENSIONS NEEDS TO BE ACCESSIBLE AND TO BE FRAMED IN LANGUAGE WHICH CONSUMERS USE.

[7] Source: "Longevity Risk", Institute and Faculty of Actuaries, December 2015

CONSUMER AWARENESS AND EDUCATION

Distribution and access to advice and guidance

It is likely that the distribution of the PEPP will be through a number of different channels. Key to the success of the PEPP will be access to cost-effective guidance and advice on the characteristics of a PEPP as well as the ease with which it can be bought (it is worth noting that more than half of all household assets across Europe are held in cash[8]).

Professional investment advice is one of the fundamental elements which drives consumer confidence and market participation. Efforts to encourage the take up of financial advice and guidance are needed to give European citizens the tools they need to make effective retirement planning decisions.

EFFORTS TO ENCOURAGE THE TAKE UP OF FINANCIAL ADVICE AND GUIDANCE ARE NEEDED TO GIVE EUROPEAN CITIZENS THE TOOLS THEY NEED TO MAKE EFFECTIVE RETIREMENT PLANNING DECISIONS.

Consider a wide variety of distribution and advice channels

The PEPP has been conceived as a Pillar 3 product which can be bought alongside other long-term savings products (such as UCITS) through traditional bank or insurance-based distribution networks and independent financial advisors, or directly through online execution platforms. However, research shows that in many EU Member States consumers do not have a relationship with a professional advisor[9]. This leaves many potential customers without access to the type of support they need to take a decision to invest and this runs the risk that the cautious or uniformed consumer may avoid engaging with the concept of a PEPP at all. We identify two channels which can help consumers without an advisor:

1. **Internet-based distribution**: The development of new digital advice and guidance channels and direct to consumer internet platforms may assist in raising brand awareness and help consumers in choosing a PEPP. Defining clear standards of advice and guidance will help to grow the role of these types of channels in the distribution of the PEPP.

2. **The role of employers in the distribution chain**: Access to workplace support and advice is likely to be another key component in building recognition of the PEPP. The ability of employers to handle contributions through payroll deduction is a major facilitator of pension saving. Facilitating access to workplace guidance and advice, especially as to how a Pillar 3 option such as a PEPP can complement existing Pillar 2 options, would be a notable enhancement. Employer engagement of this nature is significant in terms of the long-term sustainability and integrity of the pensions system. Not all employers, especially smaller employers, will have the ability to provide their own Pillar 2 schemes, unless they have access to sector-wide schemes. Consequently, Pillar 3 schemes may well prove a cost-effective way for these employers to deliver the benefits of long-term retirement savings to their employees.

THE ABILITY OF EMPLOYERS TO HANDLE CONTRIBUTIONS THROUGH PAYROLL DEDUCTION IS A MAJOR FACILITATOR OF PENSION SAVING.

[8] EFAMA "2016 Fact Book", p.35, 2016
[9] Source: BlackRock, Investor Pulse 2015 – comparative chart cited at p.7 of BlackRock response on Joint Committee Discussion on automation in financial advice, March 2016

CONSUMER AWARENESS AND EDUCATION

Defining the standards of advice and guidance

If entities such as employers are to be involved in facilitating access to the PEPP it is important to carefully define the potential liabilities of participants in the distribution chain. If employers, as generally unregulated entities, believe they have any form of onerous duty or liability imposed on them, they will not facilitate distribution.

It is recommended that a distinction be drawn between a standard generic description of what a PEPP is, and its potential benefits, and full personalised investment advice. Impartial guidance standards developed by EIOPA which fully integrate the principles of treating customers fairly, subject to norms provided by an independent body, could provide a valuable adjunct to the third party support provided by financial advisers, consumer bodies or national guidance providers. Impartial standards would have the important benefit of providing consistent levels of guidance to savers. They could also form the basis of offering safe harbours by limiting potential liability for those who meet these impartial guidance standards. For example, safe harbours may be considered for employers if they facilitate the sale of a PEPP in accordance with these standards (e.g. by access to subsidised financial advice.)

COMMON EUROPEAN STANDARDS ON INVESTMENT ADVICE AND GUIDANCE COULD PROVE INSTRUMENTAL IN ENABLING THE DISTRIBUTION OF THE PEPP.

LESSONS LEARNED FROM OPERATING UCITS FUNDS ON A CROSS-BORDER BASIS

With over €8.6 trillion in net assets under management[10], UCITS is arguably the most successful EU retail consumer financial product. The positive experience of UCITS serves as an example of what can be achieved at EU level to develop a cross-border framework. As we have highlighted in this paper, there are many aspects of the legal and regulatory framework for the PEPP which can be modelled on the UCITS regime. These include:

- a prescribed set of eligible assets;
- segregation of savers' assets;
- cross-border passporting;
- a common set of marketing rules; and
- reduced cross-border administration requirements.

Specifically in relation to the challenges of cross-border distribution, building on the UCITS experience in order to prevent national barriers to distribution will be critical to ensure the success of the PEPP. Areas where barriers arise include:

- the definition of marketing;
- use of local agents;
- regulatory fees and notification; and
- administration;

The definition of marketing

A common set of marketing rules and a common definition as to what constitutes marketing, developed by EIOPA with input from ESMA, would be desirable to avoid having to create and seek approval for multiple versions of similar marketing material. National marketing rules can create barriers to the distribution of retail products and this has been the experience with UCITS. Inconsistent national definitions and requirements have impeded the cross-border distribution of UCITS and such experiences should be avoided with the PEPP.

Use of local agents

When distributing UCITS on a cross-border basis, there are wide-ranging and divergent requirements across Member States relating to both the nature and scope of local agent activities. Certain countries require the appointment of 'local paying agents' in the jurisdiction in which the UCITS is being passported, whereas others require that a 'local representative agent' or 'local information agent' be appointed. This difference is not restricted to title - their roles also vary significantly. This divergence is also reflected in the fees charged by such entities and how these are calculated, which is exacerbated by the lack of meaningful competition in some Member States. Resource costs (both internally and externally) also need to be factored into the use of local agents, as negotiating agreements, commercial terms and ensuring that there is sufficient operational oversight, can be expensive.

In developing a framework for the PEPP, the appointment of a local agent should not be a requirement. The provision of information or payment facilities to a PEPP consumer could be readily addressed using technology including online applications/portals and/or by telephone.

THE POSITIVE EXPERIENCE OF UCITS SERVES AS AN EXAMPLE OF WHAT CAN BE ACHIEVED AT EU LEVEL TO DEVELOP A CROSS-BORDER FRAMEWORK.

Regulatory fees and notification

The regulatory fees imposed in relation to the distribution of UCITS products diverge significantly, both in terms of size and means of calculation. The arrangements governing the payment of regulatory fees also differs relative to the timing of notification, with certain regulators requiring pre-notification fees, and with others requiring post notification fees, which creates an administrative burden.

[10] Source: EFAMA "Quarterly Statistical Release", Q4 2016

LESSONS LEARNED FROM OPERATING UCITS FUNDS ON A CROSS-BORDER BASIS

Simple measures to address such shortcomings could include centralisation of the product notification procedure and the fees payable. For example, EIOPA could publish and maintain a database of regulatory fees on a specific internet portal, together with the related notification procedures. Regulators should also be required to provide confirmation of the payment of fees immediately in order to facilitate the notification process, especially where payment of fees is a pre-condition to notification.

Administration

To be a success, the PEPP must be underpinned by an administrative framework which works efficiently across Member States. Without this, the cross-border nature of the product and its potential scalability will be undermined.

Standardising data requirements

A key component of an effective administrative framework will be the standardisation of data, in the areas of disclosure to consumers and reporting / communication standards between PEPP providers and the relevant authorities. The portability of the PEPP is dependent upon these streamlined processes.

In terms of disclosure to consumers, a standard pre-transaction pensions-focused disclosure document should be developed, providing consumers with clear and transparent disclosures of the key aspects of investing in a PEPP, together with an explanation of the associated costs. This would also provide for a simple and meaningful comparison of PEPP products offered by providers, which would help to increase market competition and enhance consumer engagement with personal pensions.

Standardising regulatory, taxation and client reporting / data requirements would also be integral to the effective operation of the PEPP, particularly when considering the use of technology in this context (e.g. reporting via an online platform - see "Harnessing technology"). This is particularly relevant in the area of taxation. Currently, as with taxation regimes themselves, reporting requirements vary significantly between Member States. However, given that full tax harmonisation is unlikely for the PEPP, full standardisation of reporting / data requirements will not be feasible. Notwithstanding this, there are a number of fields within the reporting formats that could be made uniform, reducing the administrative burden for providers.

Harnessing technology / online platforms

Centralising the administrative processes upon which the PEPP is to be grounded is integral to making it a portable, cross-border product. The most effective way of doing this would be to harness the technology available, particularly via the internet or by telephone.

The use of online platforms could increase operational efficiency for the PEPP. An ambitious approach would be to establish an EU-wide platform through a public-private partnership between PEPP providers and national authorities. Such a platform could feature:

- a common settlement hub for PEPPs;
- fully integrated and automated data management; and
- a means of integration / interaction between PEPP providers and relevant regulatory / tax authorities.

In terms of portability, such a platform could be utilised to enable consumers to transfer their personal pension products across Member States and between providers. This would need to be supported by an accommodating legal and regulatory structure. By way of an example of the viability of such a platform, in Portugal, providers have supported the development of a common platform (used on a voluntary basis) to facilitate consumer transfers between personal pension products.

LESSONS LEARNED FROM OPERATING UCITS FUNDS ON A CROSS-BORDER BASIS

Although a common EU-wide platform would be advantageous in terms of the administration of a cross-border PEPP product, there are clear and inherent logistical difficulties associated with this. For example, determining who would fund the development (providers or national bodies) and where responsibilities would lie would be particularly difficult. A solution may therefore be for PEPP providers to develop their own platforms in order to manage their cross-border activity (incorporating very similar features as those outlined above). This would be an easier proposition, given that (i) EU-wide national authority buy-in would not necessarily be required (providers can tailor their approach); and (ii) many potential PEPP providers have experience in creating effective online platforms for their existing products.

In addition, in order to remove further administrative barriers to the PEPP, it is important that online e-identification tools are made available to consumers (backed by anti-money laundering legislation which considers digitalisation), potentially via platforms. A European digital ID (as considered by the European Commission's Green Paper on Retail Financial Services) could provide an efficient way to address this.

AN AMBITIOUS APPROACH WOULD BE TO ESTABLISH AN EU-WIDE PEPP ADMINISTRATION PLATFORM THROUGH A PUBLIC-PRIVATE PARTNERSHIP BETWEEN PEPP PROVIDERS AND NATIONAL AUTHORITIES. IN THE ABSENCE OF THIS, A PRACTICAL SOLUTION MAY BE FOR PEPP PROVIDERS TO DEVELOP THEIR OWN PLATFORMS IN ORDER TO MANAGE THEIR CROSS-BORDER ACTIVITY. THE DEVELOPMENT OF A EUROPEAN DIGITAL ID WILL ALSO PLAY A KEY ROLE IN ENHANCING ADMINISTRATIVE EFFICIENCIES.

THE ROLE OF TAXATION

By the very nature of the product (and the importance of taxation in its attractiveness to consumers), ensuring efficient and workable tax treatment across Member States is integral to the success of the PEPP. Full harmonisation is unrealistic in this respect - existing taxation regimes for personal pensions differ significantly between jurisdictions and Member States would undoubtedly want to retain this within their competency.

However, to establish a suitable infrastructure for a successful PEPP and, by reference to the main taxation regimes applying to personal pensions within the EU, it is important to assess whether or not an existing regime could be appropriately leveraged to support this product.

A brief description of the three main pension taxation regimes are set out below:

- **TEE (Taxed, Exempt, Exempt)**: Tax applied at contribution stage (i.e. out of net income after tax). Exempt from tax in both accumulation and withdrawal
- **EET (Exempt, Exempt, Taxed)**: Tax exempt at the stages of contribution and accumulation. Tax applied on withdrawal
- **ETE (Exempt, Taxed, Exempt)**: Contributions and withdrawal are tax-exempt. Tax applied at fund level / accumulation stage

The majority of Member States apply a variant of the EET regime to personal pension products, including Germany, Ireland, Luxembourg, the Netherlands, Spain and the United Kingdom. Within the same broad tax regime, jurisdictions have adopted their own specific rules on contributions, returns and withdrawals. This represents a significant limitation to a truly cross-border product.

In light of the fact that an ETE regime would be the most complicated to implement (due to the need to deal with withholding tax and capital gains during the accumulation phase), the most appropriate taxation regimes for the PEPP would appear to be either the TEE or EET. As a means of comparison, the key features / benefits of both these regimes (in relation to the PEPP) are set out in the table below:

Regime	Features / Benefits
TEE	• This regime could be applied uniformly across Member States: there would be no operational requirement to perform any specific tax work for the PEPP product, as it would be tax exempt (contributions are taxed). This would assist greatly in the portability of the PEPP. • This portability may also be attractive to individuals invested in an existing national private pension subject to an EET regime.
EET	• An EET regime would be viable given that a taxable event would only occur once during the life of the PEPP (at the withdrawal stage). • It is possible, though, that the withdrawal tax would have to be paid in the country where the PEPP holder benefitted from the tax exemption on his/her contributions and returns during the accumulation period. This would require the PEPP provider to handle different tax compartments for individuals moving from one country to another, while continuing to save into the same PEPP.

THE ROLE OF TAXATION

Although, both in terms of portability and operational ease, a TEE regime would appear to be the most simple tax solution for the PEPP (as outlined in the table on the previous page), there would be concerns as to how Member States would implement this at a national level. Even in Member States that ostensibly operate the same taxation regime in respect of personal pensions (e.g. EET, ETE or TEE), each jurisdiction has established specific rules in terms of the mechanics of taxing these products. This raises the prospect of material divergence between Member States, limiting the development of a truly cross-border product.

The key is to find a solution which enables PEPP products to make the best use of taxation rules in each jurisdiction in order to minimise the impact of taxes upon the savings of consumers. The most effective way forward, and the primary challenge, is to ensure that the regulations governing the PEPP allows for the product to take advantage of the same tax treatment as equivalent local products on a Member State by Member State basis. It could be tempting to allow Member States to impose national restrictions to a PEPP offered in their own country in order to increase the likelihood that they would grant tax incentives to invest in the PEPP. However, such an approach would in effect enable Member States to keep barriers in place to the cross-border distribution of the PEPP.

Key to the success of the PEPP is that such products have the ability to mitigate or eliminate withholding taxes on investment income and gains generated through the mechanics of domestic law or the relieving provisions included in double tax agreements. While 'pensions' in general do have the ability to qualify for treaty benefits when investing in EU Member States on the basis of being considered a 'resident' for treaty purposes, uncertainty arises in some Member States which in effect results in the inability to obtain treaty benefits. In addition, while relief may be available, the procedures for claiming that relief are in many cases unclear, resource intensive and costly, resulting in long periods of time to obtain the relief (in many cases, years). In this regard, the European Commission's work in addressing national barriers to capital flows[11] is critical in this area.

This challenge is certainly not insurmountable. The UCITS regime has no corresponding tax harmonisation framework directly associated with it, yet this product has been hugely successful (by reference to both the amount invested in this product and common consent). In the pensions world the RESAVER Pension Fund, for example, enables mobile and non-mobile employees to remain affiliated to the same pension vehicle when moving between countries and when changing jobs, despite the differences in tax, labour and social laws between Member States.

In any event, a standardisation of tax reporting requirements (to the greatest extent possible) (see 'Standardising data requirements') and tackling burdensome withholding tax refund procedures (applicable not only to private pension products but to all kinds of financial instruments) would certainly simplify the taxation regime applicable to the PEPP, even if a harmonised EU-wide private pensions taxation framework would appear to be some distance away.

TAX HARMONISATION IS UNREALISTIC. HOWEVER, TO BE SUCCESSFUL, THE PEPP NEEDS TO BE AFFORDED THE SAME LOCAL TAX TREATMENT AS COMPARABLE NATIONAL PRIVATE PENSION PRODUCTS.

[11] See Section 4.2 of Commission Report "Accelerating the capital markets union: Addressing national barriers to capital flows", COM(2017) 147 final, 23 March 2017

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June 2017