Pan-European pension product

European added value assessment accompanying the European Parliament’s legislative initiative report (Rapporteur: Sophia in ’t Veld)
IN-DEPTH ANALYSIS

European added value assessment on the pan-European pension product (PEPP)

Abstract

In June 2017, the European Commission proposed a framework for a pan-European pension product (PEPP) designed to give EU citizens a new option for good value and safe voluntary supplementary pension saving. This could support pension adequacy and at the same time provide another source of long-term investment funds and so help to meet the objectives of the capital markets union (CMU). Together with a proposal for a regulation for a pan-European personal pension product, the Commission also presented a recommendation to encourage Member States to grant the same tax treatment to PEPPs as they grant to similar existing national personal pension products.

On 11 January 2018, the Conference of Presidents of the European Parliament authorised its Committee on Economic and Monetary Affairs (ECON) to draft a legislative own-initiative report on the 'Tax treatment of pension products, including the pan-European personal pension product 2018/2002(INL)', to be prepared by the rapporteur Sophia in ‘t Veld (ALDE, the Netherlands) – see the proposal for a motion for a resolution in Annex 1. All legislative own-initiative reports are automatically accompanied by a European added value assessment (EAVA). The purpose of an EAVA is to support a European Parliament legislative initiative by providing an assessment of the potential added value of taking action at EU level.

Two European Parliament draft reports have been prepared as part of the process leading to a decision regarding the European Commission PEPP proposal and PEPP recommendation. The first draft report covers the PEPP proposal and the second the PEPP recommendation. This EAVA analyses both the PEPP proposal and the recommendation and provides information in support of the committee’s draft report on the Commission’s PEPP recommendation.

There exists clear evidence for the European added value to be achieved through the PEPP. As the PEPP facilitates cross-border mobility by providing a simpler pension product for people who have worked or who plan to work in several Member States, it would contribute to the free movement of people. An economic dimension derives from the fact that supranational operations deliver greater benefits to Members States (increased voluntary pension savings), savers (better and cheaper products, larger variety of products) and service providers (larger customer base, simplified legislation, fewer cross-border transaction costs).
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Executive summary

The population of the European Union, having grown strongly, is now stagnating while continuing to age dramatically, owing to lower birth rates and increasing life expectancy. In 2006 there were four people of working age (15 to 64) for each person aged 65 or over – by 2050 this ratio is projected to be just two to one. This has put pressure on pension systems given that it is (largely) the taxes and contributions of current workers that pay for current pensions. Reforms to improve the sustainability of pensions have been successful in mitigating rising costs. Overall EU spending on public pensions as a percentage of gross domestic product (GDP) is now expected to be similar in 2060 to today’s level. However it is not clear yet what the impact on pension adequacy may be and much will depend on peoples’ ability and willingness to work more and longer to compensate for later and lower pension provision. Various kinds of supplementary pensions may also play a role in supporting pension adequacy in some cases.

Against this backdrop, in June 2017 the European Commission proposed a framework for a pan-European pension product (PEPP) designed to give EU citizens a new option for good-value and safe voluntary supplementary pension saving. The Commission proposal and recommendation could support pension adequacy and at the same time provide another source of long-term investment funds and so help to meet the objectives of the capital markets union (CMU). The European Commission, supported by the European Insurance and Occupational Pensions Authority (EIOPA), developed the proposal over a number of years. PEPPs will be authorised by EIOPA and will be transparent in terms of charges, use modern digital communication channels by default and allow switching of fund choices and providers periodically at a ‘reasonable’ cost.

A key success factor is the tax treatment of the PEPP. In order to address the taxation issue, the Commission has also presented a separate recommendation to encourage Member States to grant the same tax treatment to PEPPs as they grant to similar existing national personal pension products. As taxation is a competence of the Member States, any EU-level action regarding taxation necessitates a unanimous decision in the Council of Ministers. Consequently the European Commission may have assessed that it was not likely to obtain unanimity in the Council on a tax proposal, and therefore opted to make a separate recommendation instead of a proposal for legal action.

Two draft reports have been prepared in the European Parliament as part of the process leading to the decision regarding the European Commission PEPP proposal and PEPP recommendation. The first draft report covers the PEPP proposal and the second draft report covers the PEPP recommendation. This European added value report analyses the PEPP proposal and recommendation and provides information in support of the draft report on Commission’s PEPP recommendation.

To address the issue of different national rules on personal pension products, the concept of 'national compartments' was established to ensure PEPPs could be designed in such a way as to be compliant with the (different) national rules to be granted national tax relief.

Another important point for a PEPP saver will be the impact of charges over the long-term period when pension savings are accumulated. Costs (i.e. annual, performance,
management, etc.) can add up to significant amounts over the savings period through compound interest effects. Therefore, a key success factor for a PEPP will be the management of costs.

There exists a convincing case for European added value in the context of the PEPP. It should contribute to the free movement of people – as the PEPP will facilitate cross-border mobility by providing a simpler pension product for those who have worked or plan to work in several Member States. The economic dimension derives from the fact that supranational operations deliver larger benefits to Member States (increased voluntary pension savings), savers (better and cheaper products, larger variety of products) and service providers (larger customer base, simplified legislation, fewer cross-border transaction costs). Indirect impacts and possible leverage achieved through the better allocation of financial resources in the context of the capital market union has the potential to enhance Member States’ economic activity thus contributing to GDP growth, which in turn has a positive impact on the sustainability of Member States’ fiscal situations, allowing the sustainable financing of public (so-called pillar 1) pensions. For more details on different configurations of pension products see Annex 2 – Pension glossary and taxonomy of this paper.
1 Background

1.1 Demographic developments – a dramatically ageing EU28
The EU’s population has grown strongly in recent decades from a little over 400 million people in 1960 to over 500 million today – an increase of around a quarter. However this growth has now slowed down and in the future it is expected that the population will stagnate and then decline somewhat. The main reason for this is the falling birth rate, which has dropped from an EU28 average of about 2.5 children per woman in 1960 to under 1.6 today. EU citizens are also living longer, on average, than in the past. EU citizens born today can expect to live around an extra 10 years on average, compared with those born in the early 1960s. Combined, this increasing longevity and falling birth rate have also had and will continue to have a dramatic impact on the age structure of the EU28 population, leading to a much older EU. The working age population (aged 15 to 64) shrank for the first time in 2010 and is expected to decline every year to 2060. In contrast, the proportion of people aged 80 or over in the EU-28 population is expected to more than double by 2050, reaching 11.4 %. In 2006 there were four people of working age (15-64) for each person aged 65 or over – by 2050 this ratio is projected to be just two working age people to each person aged 65 plus. This outlook is essentially set for the shorter term, meaning the focus is on smoothing and adapting to older populations. For more in depth information see ‘Demographic outlook for the European Union’.¹

1.2 EU-level pension policy – securing adequate and sustainable pension systems
EU-level competence on pension systems is limited, as these are largely for the Member States to determine. Nonetheless, the aim at EU level is to ensure that pension systems are both adequate and sustainable. The two high-level policy prescriptions set out in the European Commission’s 2012 white paper on pensions² were to encourage and enable people to achieve a better balance between time spent in work and in retirement and to give EU citizens better opportunities to save in safe and good value supplementary pension schemes. These ideas were generally welcomed, including by the European Parliament in its resolution on the white paper,³ and Council conclusions⁴ highlighted similar themes.

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³ Resolution of 21 May 2013 on an agenda for adequate, safe and sustainable pensions, European Parliament.
⁴ Council Conclusions, Responding to demographic challenges through enhanced participation in the labour market and society by all, as adopted by EPSCO on 21 June 2012.
1.3 Sustainability of pension systems – reforms taking effect for the future

Against the ageing demographic backdrop, pensions systems have come under serious pressure. Most pension income for most EU citizens comes from public pensions (referred to as ‘pillar I’ – see Annex 2 for an explanation of pension taxonomy). These pensions are pay-as-you-go (PAYG) meaning that current contributions of social insurance and tax paid by workers pay for the pensions of people who have already retired. This becomes harder to sustain as there are fewer people of working age supporting increasing numbers of people who are retired. It is also harder to sustain ever longer retirements (resulting from increasing longevity) paid for by a fixed period of working life. Hence many Member States have responded by reforming pension systems to make them more sustainable both now and in the future. These efforts mean that overall EU spending on public pensions as a percentage of GDP is now expected to be similar in 2060 to today’s level, despite demographic ageing, according the European Commission’s 2015 Ageing Report.5

In general, the centrepiece of national efforts has been an attempt to increase the effective retirement age (that is the actual age at which people retire, which is often earlier than the statutory pension age). Specific measures behind this are generally aligned with themes emerging at EU level and help to ensure pensions are more sustainable, while seeking at the same time to protect adequacy. For instance, requiring longer contribution periods for a full pension, tightening up early retirement schemes and increasing statutory retirement ages (including equalising women’s pension ages with men’s), in some cases linking to longevity changes in the future. Alongside these are efforts to support active and healthy ageing, life-long learning and older people’s employment, including combining work with drawing a pension – all designed to support adequacy and sustainability by enabling longer working lives. Some Member States hit hard by the economic crisis also cut pensions in payment, increased taxes or reduced the indexation of pensions in order to support sustainability, albeit at some cost to adequacy in some cases.

1.4 Pension adequacy – potentially at future risk

While the sustainability of pensions in the face of an ageing population has, through reforms, been put back on track (at least on average at EU level) the adequacy of pensions remains a concern. The European Commission’s 2015 Pension Adequacy Report6 looks at pension adequacy now and projected into the future. In short, on average, current pensioners have broadly seen their living standards maintained, albeit this hides considerable variance between and within Member States. Some groups (women, older pensioners, pensioners living alone, those who had atypical careers) in particular remain at risk. Women’s average pension income is lower than men’s in all Member States and for the EU as a whole the gender pension gap is 40 % (weighted average).

Measuring future adequacy is difficult. However, one key adequacy measure (theoretical replacement rates – TRRs) shows a decline in PAYG public pensions (pillar I) in 22 Member States hitting hard by the economic crisis also cut pensions in payment, increased taxes or reduced the indexation of pensions in order to support sustainability, albeit at some cost to adequacy in some cases.

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States in 2053, compared to today. For an average wage earner, reductions of more than five percentage points (p.p.) are projected in 16 Member States, with 15 p.p. reductions in six Member States. This may be at least partly compensated for by pre-funded statutory pension schemes (known as pillar IIb schemes) in eight Member States, while occupational (pillar II) and personal (pillar III) pensions will also help to mitigate public pension reductions in a further four Member States. See Figure 1 below.

Figure 1 – Percentage points difference between 2013 and 2053 in gross TRRs, by type of pension

This implies that meeting the aim of 'adequate and sustainable' pension systems may be in doubt, at least as far as adequacy is concerned. Much will depend on peoples' ability and willingness to work more and longer to compensate for later and lower pensions. Various kinds of supplementary pensions may also play a mitigating role in tackling adequacy concerns in some cases.  

Note: 2013 data for Greece not available. Where gender differences existed, results for men were reported in this graph.


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The EPRS briefing European Union pension systems - Adequate and sustainable? has more information on the adequacy and sustainability of EU pension systems, European Parliament, November 2015.
2 EU-level reports, evaluations and studies

2.1 Commission preparatory work, studies and impact assessment on the PEPP

In 2015, the Commission published a green paper on 'Building a Capital Markets Union'. A specific consultation question was 'Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?'

The subsequent Commission action plan confirmed that the Commission would 'explore ways to increase choices for retirement saving and build an EU market for personal private pensions that pension providers could opt for when offering private pensions across the EU'. This approach was supported by the accompanying 'Feedback statement on the green paper "Building a Capital Markets Union"', which noted that a large number of respondents supported the idea of a PEPP. Consumer organisations called for value for money, certainty and mobility, with transparency and some choice in investment and withdrawal options. The investment fund industry was strongly in favour of the PEPP. Personal pension providers felt it needed careful assessment, and that the PEPP should be explicitly retirement-focused and so be a long-term investment product with restricted early withdrawal, and include the possibility to purchase cover for longevity risk.

Building on the earlier work undertaken by itself and EIOPA, on 27 July 2016 the Commission launched a specific consultation to help assess the case for a policy framework to establish European personal pensions. Views were sought on 'possible EU action in order to offer personal pensions to individuals which are simple, affordable, transparent and provide better returns'. The consultation, which included a public hearing held on 24 October, closed on 31 October 2016, having attracted 586 responses from individuals, consumer organisations and stakeholders. A summary was ultimately published in Annex 2 of the impact assessment (see below). According to this, there was support from all stakeholders on the need to complement public and occupational pensions with personal pensions.

Retail investors supported the idea of simple transparent personal pension products whilst consumer organisations pointed to the low quality of existing PPPs and lack of transparency of costs and fees. The preferred option of providers' was for a PEPP framework, and the least-favoured option of professional respondents to the consultation was the harmonisation of existing legislation on PPPs.

The proposal for a regulation on a pan-European personal pension product (PEPP) was made on 29 June 2017 and the Commission also published a recommendation on the tax treatment of personal pension products, including the pan-European personal pension product. On the same date, the European Commission's internal think tank, the European

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11 See the Consultation document – Capital markets union: action on a potential EU personal pension framework, the public hearing and the consultation responses, European Commission, October 2016.
Political Strategy Centre, published a note 'A pan-European Pension Product – filling the pension gap and refinancing the economy'.

The proposed regulation and the recommendation were accompanied by an impact assessment (and summary) and also a 'Study on the feasibility of a European Personal Pension Framework' (and summary), which had been ordered by the Commission to assist with developing the PEPP proposal.

### 2.2 EIOPA studies on the PEPP

At the behest of the Commission, EIOPA published a discussion paper on 16 May 2013 on a possible EU-single market for personal pension products, seeking comments by 16 August 2013. As part of this, a public event was held in June 2013. A preliminary report to the Commission was published by EIOPA in February 2014. Following this report, the Commission issued a call for advice on personal pensions to EIOPA on 23 July 2014. This sought further advice and evidence from EIOPA, including the possible prudential regulation and consumer protection measures for an EU-wide framework for the regulation and supervision of personal pension products.

On 3 July 2015, taking account of the focus in the European Commission’s green paper, ‘Building a Capital Markets Union’, EIOPA issued a consultation paper on ‘the creation of a standardised Pan-European personal pension product (PEPP)’. The consultation ran until 5 October 2015. Having considered this feedback, EIOPA published its final advice on the PEPP on 1 February 2016, and a final report on the public consultation was published on 11 April 2016.

### 2.3 Description of the proposed PEPP

The PEPP proposal (COM(2017)343), put forward in June 2017, sets out a framework within which PEPP products can be designed and sold. PEPPs will be voluntary personal pension products (i.e. a type of pillar III pension) giving EU citizens a new option for making complementary savings for retirement. It could be offered by a broad range of financial companies such as insurance companies, banks, occupational pension funds, certain investment firms and asset managers. The proposed PEPP offers the following key features:

- PEPPs will be voluntary and complementary (i.e. they will not replace or harmonise national provisions) contracts between individual pension savers and

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12 [Proposal](http://example.com) for a regulation on a pan-European Personal Pension Product (PEPP), [Recommendation](http://example.com) on the tax treatment of personal pension products, including the pan-European Personal Pension Product, [European Political Strategy Centre note](http://example.com) A pan-European pension product – filling the pension gap and refinancing the economy, European Commission, all June 2017.

13 [Impact assessment and Summary](http://example.com) and [Study on the feasibility of a European personal pension framework](http://example.com) and [Summary](http://example.com), European Commission, June 2017.


15 [EIOPA](http://example.com) [consultation paper](http://example.com) on ‘the creation of a standardised Pan-European Personal Pension product (PEPP)’, July 2015. EIOPA [final advice](http://example.com) on the PEPP, February 2016, and [final report](http://example.com) on the public consultation, April 2016.
PEPP providers with an explicit retirement objective providing capital accumulation until retirement with only limited early access, and providing an income on retirement.

- PEPPs will be authorised by the European Insurance and Occupational Pensions Authority (EIOPA) and providers wishing to apply for PEPP authorisation will need to be financial undertakings already authorised at EU level by the competent authorities under the applicable sectorial legal instrument.

- PEPPs will be a pan-European product and hence savers will be able to keep their PEPP when moving to another Member State (portability of the service). However, given the very different national regimes across the EU, PEPPs will operate as a series of national compartments, each compartment being compliant with national rules, for instance to allow them to obtain tax relief. Anyone offering a PEPP must make savers aware of which national compartments are available with the product and must in all cases ensure compartments are available to cover all Member States three years after the entry into application of the regulation.

- PEPPs will be transparent with electronic communication as the default. A key information document (KID) will be produced for each PEPP, setting out specified standard information, building on existing rules in the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation (Regulation (EU) No 1286/2014). This will include information on any guarantees, switching, portability, and environmental, social and governance factors and, in contrast to PRIIPs Regulation rules, providers will also have to set out information on past performance over at least five years, or the maximum available.

- The proposal distinguishes between PEPP providers and PEPP distributors. The former will be expected to conduct a suitability and appropriateness test of potential PEPP savers, although savers may waive their right to receive advice if they opt for the default option.

- Regular PEPP benefit statements, based on similar criteria set out in the directive on the activities and supervision of institutions for occupational retirement provision (IORP II) (Directive 2016/2341/EU), must be provided, giving specified information on accrued entitlements or accumulated capital and any guarantees applicable.

- Investment policies must follow the 'prudent person' provision. Up to five investment options are to be offered, one of them being a default that protects at least the capital invested. The investment choice can be changed free of charge once every five years. The Commission is given powers through delegated acts to set the risk-mitigation technique for the default options and alternative options. Other accumulation criteria, such as age limits, maximum amounts of contributions and early redemption rules are for Member States to set.

- PEPPs are allowed to offer the option of coverage for biometric risk (i.e. longevity, disability and death).

- PEPP savers can switch providers once every five years at a 'reasonable' cost, capped at 1.5 % of the PEPP positive balance.

- Most rules relating to the decumulation (pay-out) phase are for Member States to determine, including: setting the retirement age; a mandatory link between reaching retirement age and the start of the decumulation phase; a minimum
period of belonging to a PEPP scheme; a maximum period before reaching retirement age for joining a PEPP scheme; and redemption rules in case of hardship. Pay-out forms offered by PEPP providers may be one or more of: annuities; lump sum; drawdown payments; or a combination of these.

- EIOPA is required to monitor pension schemes established or distributed in the territory of the EU, to ensure the designation PEPP is only used by those authorised under the proposed regulation.

- The European Commission is given the power to adopt delegated acts in the areas of: standardised format for the distribution of information to aid consumer understanding of risks and the making of comparisons; how to comply with distribution rules for non-advised PEPPs, including information to be obtained to assess the appropriateness of PEPPs for consumers, and certain criteria for default funds not requiring advice; assumptions for benefit projections, information standards for reporting to national authorities and specifying risk-mitigation techniques for default and non-default fund options.

Figure 2 (below) is a graphical representation of how the PEPP compartments will work. Note that where a Member State has more than one national regime, there may be more than one national compartment offered by providers. Money is saved in national compartments meeting the national requirements for tax relief on pension savings, including the payout rules, for instance on the earliest age at which money can be accessed or the form in which payouts are possible (e.g. lump sum or annuity)."
Figure 2 – Proposed PEPP structure

PEPP compartments are necessary to get tax relief

Person 'X' living in Member State 'A'
- If they move
  - Stays with provider '1'
  - Selects new provider for country 'B' compartment

PEPP provider '1'
- Member States' compartments compliant with national rules to grant tax relief
  - MS 'A'
  - MS 'B'
  - MS 'C'...
  - MS 'Z'

Pool of PEPP assets † managed by provider ‘1’
- # Payout rules consistent with national rules of
  - MS 'A'
  - MS 'B'
  - MS 'C'...
  - MS 'Z'

Retirement payouts to person 'X' from national compartments taxed according to their tax residency
- MS 'A'
- MS 'B'
- MS 'C'...
- MS 'Z'

Person 'X' living in Member State 'B'
- Can change provider (allowed once every 5 years at 'reasonable' cost)
  - MS 'A'
  - MS 'B'
  - MS 'C'...
  - MS 'Z'

PEPP provider '2'
- Member States' compartments compliant with national rules to grant tax relief
  - MS 'A'
  - MS 'B'
  - MS 'C'...
  - MS 'Z'

Pool of PEPP assets † managed by provider ‘2’
- # Payout rules consistent with national rules of
  - MS 'A'
  - MS 'B'
  - MS 'C'...
  - MS 'Z'

Notes:
† There may be more than one compartment by Member State to cover different national regimes
# With asset taxation according to national rules
# e.g. annuity, lump sum, minimum age to take payout...

Source: European Parliament

EPRS | European Parliamentary Research Service
2.4 European Parliament briefing and appraisal of the PEPP

European Parliament Policy Department A published a study on EU pension schemes aimed at providing the Employment and Social Affairs (EMPL) Committee with information about the risks and replacement rates of different pension schemes. The study concluded that large variations exist in the approach to pensions in the EU Member States. Vulnerable groups are less likely to contribute to individual plans or 'third-pillar' schemes, which complicates a shift in replacement rates from pillars 1 (aimed at avoiding old age poverty) and 2 (occupational schemes) to pillar 3. Pillars 1 and 2 should ensure pension adequacy, leaving pillar 3 as a tool for individuals to enhance their replacement rates.  

In addition to that, the European Parliamentary Research Service (EPRS) published the first edition of its legislative briefing on the PEPP and an initial appraisal of the European Commission's impact assessment on the PEPP in October 2017. The legislative briefing stated that Europe's population is ageing on account of people living longer and having fewer children, putting increased pressure on pension systems. This has led to reforms to make public pensions more sustainable – and often less generous – in future. This leads to a need to develop third pillar of voluntary pension savings in Europe. 

The initial appraisal concludes that the Commission's impact assessment provides useful input on the potential implications of the creation of a pan-European pension product. The initial assessment observed that while the elements provided are generally logical, some parts of the analysis lack consistency and could have been more complete. For instance, a clearer definition of the problems could have provided more solid ground for the analysis – even more so as the impact assessment does not provide operational objectives and features a limited range of options.

2.5 European Parliament draft reports

Two European Parliament draft reports have been prepared as part of the process leading to the decision regarding the European Commission PEPP proposal and PEPP recommendation. The first draft report covers the PEPP proposal and the second draft report covers the PEPP recommendation.

The draft report regarding the Commission PEPP recommendation contains three suggestions, namely:

- granting the same tax relief to the PEPP as that granted to national personal pension products, even in cases where PEPP features do not fully match all the national criteria;
- granting specific tax relief to the PEPP, harmonised at Union level, to be laid down in a multilateral tax agreement between Member States;

17 Pension Schemes, Policy Department A for Economic and Scientific Policy, European Parliament, August 2014.
20 Draft report with recommendations to the Commission on tax treatment of personal pension products, including the pan-European Personal Pension Product.
granting a specific subsidy or premium to PEPP savers, in the form of a fixed amount or fixed percentage.

The suggestions support and develop the Commission recommendation:

'Member States are encouraged to grant PEPPs provided under Regulation (EU) .../... of the European Parliament and of the Council 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.

'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.

'In order to accelerate the creation of a single market for personal pensions, Member States are encouraged to exchange best practices regarding the taxation of PEPPs and PPPs, with a view to aligning their national criteria for granting tax incentives as much as possible and facilitating the portability of such products.'

2.6 Other EU institutions' views

The European Economic and Social Committee (EESC) adopted its opinion on the PEPP proposal in October 2017 (rapporteur Philip Von Brockdorff (Workers – Group II, Malta)). It recognised that the European pension landscape is fragmented and, welcomed the attempt to encourage EU citizens to benefit fully from the single market by making adequate provision for their retirement years. However, in the same opinion, the EESC recalled the need to provide consumers/savers with clear information as well as to ensure capital protection under the default low-risk option.²¹

2.7 National parliaments' views

No national parliaments issued a reasoned opinion on the grounds of subsidiarity by the 27 October 2017 deadline. Spain had important information to exchange, with political dialogue on the proposal in Italy, Portugal and Romania.²²

2.8 Other studies and views

Some key stakeholder reactions and views on pensions and on the PEPP include those from:²³

- Insurance Europe (representing Europe's insurance and reinsurance companies), which published an insight briefing and a position paper in January 2018;
- PensionsEurope (the representative of European pension funds), which published a position paper on the PEPP in January 2018;

²² See IPEX, The platform for EU Interparliamentary Exchange.
²³ The previously mentioned EPRS legislative briefing summarises stakeholders' initial reactions to the PEPP. Links to full stakeholder positions and other key information are here: Insurance Europe, insight briefing and position paper; PensionsEurope press release and position paper; EFAMA, flyer and position paper; Aviva note Mind The Gap; CFA Institute; Better Finance; AFME; Finance Watch; OECD stocktaking; Pensions at a glance - 2017, Pension markets in Focus; European Commission European semester thematic factsheet, Adequacy and sustainability of pensions.
the European Fund and Asset Management Association (EFAMA), which published a flyer on its views on the PEPP and in September 2017 a position paper;
• Aviva, an global insurer and asset manager, which published a note 'Mind the Gap' quantifying the pension savings gap in Europe and showing that Europe's pension savings gap remains substantial, surpassing €2 trillion a year – equivalent to 13% of Europe's GDP;
• the Chartered Financial Analyst (CFA) Institute;
• Better Finance;
• the Association for Financial Markets in Europe, AFME;
• Finance Watch (Finance Watch is an independent non-profit Members' association set up in 2011 to act as a public interest counterweight to the powerful financial lobby);
• the OECD, which published a stocktaking of the tax treatment of funded private pension plans in OECD and EU countries. It also issued a publication 'Pensions at glance – 2017' highlighting the pension reforms undertaken by OECD countries over the last two years. Moreover, one special chapter focuses on flexible retirement options in OECD countries and discusses people's preferences regarding flexible retirement, the actual use of these programs and the impact on benefit levels. The OECD publication 'Pension markets in Focus – 2017' covers 85 countries and gives an overview of private pension systems worldwide and outlines latest developments. It assesses the amount of assets in funded and private pension plans, describes the way these assets are invested in financial markets, and looks at how investments have performed, both in the past year and over the past decade;
• the European Commission; which issued a European semester thematic factsheet on the 'Adequacy and sustainability of pensions'.

3 Taxation

Together with the proposal for a PEPP Regulation, the European Commission adopted a recommendation that concerns Member States' application of tax rules to individuals who qualify as PEPP savers. In this recommendation, the Commission encourages Member States to grant PEPPs the same tax treatment as that granted to national personal pension products (PPPs). In the event that Member States have more than one type of tax regime for national PPPs (e.g. a Member State could grant beneficial tax treatment at the accumulation phase and/or during decumulation phase), they are encouraged to give PEPPs the most favourable tax treatment available to their national PPPs.

A study on the feasibility of a European personal pension framework, requested by the European Commission, identified 49 different pension products in 28 Member States that were voluntary, non-state based (excluding first and second pillar pensions) retirement financial products. Each of these 49 products could be taxed differently based on the

24 Taxation belongs to the competence of the Member States. Any EU-level action regarding taxation therefore necessitates a unanimous decision in the European Council of Ministers. Consequently the Commission may have decided that it was not likely to obtain unanimity in the Council and therefore opted to make a recommendation instead of a proposal for legal action.

specificities of each Member State’s pension system. In schematic terms, taxation can occur on three occasions, namely during the accumulation phase, the yield phase and the decumulation phase. There are eight different taxation-combinations based on these three phases.

**Table 1 – Different taxation options**

<table>
<thead>
<tr>
<th>Combination</th>
<th>Accumulation</th>
<th>Yield</th>
<th>Decumulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (EEE)</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>2 (EET)</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Taxed</td>
</tr>
<tr>
<td>3 (ETT)</td>
<td>Exempt</td>
<td>Taxed</td>
<td>Taxed</td>
</tr>
<tr>
<td>4 (ETE)</td>
<td>Exempt</td>
<td>Taxed</td>
<td>Exempt</td>
</tr>
<tr>
<td>5 (TTT)</td>
<td>Taxed</td>
<td>Taxed</td>
<td>Taxed</td>
</tr>
<tr>
<td>6 (ETE)</td>
<td>Taxed</td>
<td>Taxed</td>
<td>Exempt</td>
</tr>
<tr>
<td>7 (TEE)</td>
<td>Taxed</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>8 (TET)</td>
<td>Taxed</td>
<td>Exempt</td>
<td>Taxed</td>
</tr>
</tbody>
</table>

Source: table compiled by the author.

Consequently there is a very high number of possible combinations of tax treatments across all Member States. Further sub-variations are possible, as, for instance, tax exemptions can take different forms, such as direct tax reduction, a reduced tax base or tax credit.

Each Member State has selected a tax-treatment based on national preferences, and in order to get a tax advantage, strict conditions need to be followed. The most significant parameters are retirement age and out-payment modalities.

The current minimum age (and other conditions) to access PPPs varies considerably across the Member States. The pillar I pensionable age (retirement age) is often set to increase in the coming years and the pensionable age for national PPPs is also increasing in some cases as explained by the Finnish Centre for Pensions.26 According to the Ernst & Young study on the feasibility of a European Personal Pension Framework,27 it is possible to identify the following:

Accumulation phase
- 7 products are taxed in six Member States.
- 39 products are classified as partially exempt in 24 Member States.

Yield phase
- 12 products out of 49 are subject to taxation on yield.
- 37 products in 23 Member States are exempt.

Decumulation phase (see details in Figure 3 below)

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26 Retirement ages in Member States, Finnish Centre for Pensions, 2017.
27 Study on the feasibility of a European Personal Pension Framework, Ernst & Young for the European Commission, June 2017.
In order to have a common PEPP taxation regime across 28 Member States, there is a need to create a product that presents an average of the characteristics of all existing products. While this is technically possible, it is questionable whether Member States would grant a tax benefit to a PEPP that provides better conditions than national pension products. For example, if the PEPP were to set 65 as the minimum age at which benefits could be accessed, Member States where benefits could be accessed later than 65 would not grant tax relief for contributions paid to the PEPP.

The minimum age for accessing benefits varies considerably across the Member States and hence setting an average age would mean that in those countries with a lower age consumers will not use the PEPP whereas in those countries with a higher age consumers may prefer the PEPP. This would however undercut national policies, for instance, those aimed at encouraging people to work longer and retire later.

The same reasoning is applicable to other elements of the definition of a national PPP, such as whether outpayments should take the form of an annuity, a lump sum, or a combination of both. Member States that require an annuity or a combination of lump sum and annuity do so because they wish to ensure that their citizens will have an income

Source: Ernst & Young study.

3.1 Tax critical elements defining national PPPs

In order to have a common PEPP taxation regime across 28 Member States, there is a need to create a product that presents an average of the characteristics of all existing products. While this is technically possible, it is questionable whether Member States would grant a tax benefit to a PEPP that provides better conditions than national pension products. For example, if the PEPP were to set 65 as the minimum age at which benefits could be accessed, Member States where benefits could be accessed later than 65 would not grant tax relief for contributions paid to the PEPP.

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The same reasoning is applicable to other elements of the definition of a national PPP, such as whether outpayments should take the form of an annuity, a lump sum, or a combination of both. Member States that require an annuity or a combination of lump sum and annuity do so because they wish to ensure that their citizens will have an income
when they grow old, so that the citizens can take care of themselves and are less likely to call on the social security systems for help. These Member States will not grant tax relief for contributions paid to a PEPP allowing for 100% lump sum outpayments.

On the other hand, if the single PEPP were only to allow annuities or a combination of annuities and lump sum, it would not be able to compete with national products that allowed a 100% lump sum outpayment, since pension savers generally prefer products with lump sum outpayments.

These are just a few examples. There are many more tax critical elements, defining national PPPs, that might also prevent Member States from granting tax relief to the PEPP if its characteristics were different from the national PPPs. Examples are the maximum amount of annual inpayments and the requirement or not to provide a guaranteed return.

In the framework of the European Semesters, most Member States have received country-specific recommendations (CSRs) on pensions calling for reforms to modernise pension systems by raising and aligning the pensionable age to growing life expectancy; reducing early exit pathways; promoting complementary retirement savings, and underpinning pension reforms with measures enabling men and women to work longer. Based on the European Semester recommendations, which have been accepted by all Member States (Council adopts and European Council endorses), a specific PEPP case might in theory be possible, building a PEPP product in which the pensionable age is set, for example, at 67 years (higher than it currently is in many Member States).

To compensate for this higher pensionable age (compared with in the national PPP), Member States could offer this specific PEPP product more generous tax treatment. Consumers could choose between earlier access to pension savings (where such a PEPP has a higher age than national PPPs) with standard national tax-benefits or select a PEPP with later access to savings, but with better tax benefits (with appropriate limits setting maximum annual in-payments). As the age at which pillar I pension benefits and national PPPs can be accessed evolves (the ages are increasing in many Member States and they can also be aligned to the evolution of life expectancy), they may converge towards the PEPP. However in cases of low-income clients (with very low or no taxes), the tax-benefit system may not be an efficient motivator. In such cases a bonus-based system could be better, like the German Riester-rente system.²⁸

### 3.2 Bilateral tax conventions

There are no EU-wide rules that say how EU nationals who live, work or spend time outside their home countries are to be taxed on their income. However, the country where an individual is resident for tax purposes can usually tax total worldwide income. This includes wages, pensions, benefits, income from property or from any other sources, or capital gains from sales of property, from all countries worldwide. In some cases, two countries could consider an individual as a tax resident at the same time, and both could require the person to pay taxes on the total worldwide income. Many countries have double tax agreements, which usually provide rules to determine which of the two countries can treat an individual as a tax resident. For example Belgium has a bilateral tax-

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treaty with 23 EU Member States. The current situation has created situations in where second or third pillar outpayments are taxed in the paying country where the beneficiary is residing in that country, but where, based on a tax agreement, an individual could move to another EU country in which outpayments are tax-free.

For example the tax-agreement between Finland and Portugal provides for tax-free outpayments for the second pillar to those Finnish citizens who move their tax-residence to Portugal (while if they stay in Finland, the outpayments are taxed).

Finally, in the case of the PEPP, if it is permissible (e.g. through changes during the legislative process) to move accumulated funds from one compartment to another (e.g. before pension outpayment consolidation of all compartments to one single compartment), national compartments within a single saver consolidated PEPP should be built in order to prevent tax avoidance, for instance when a saver asks for a transfer from an EET/ETT regime to a TEE/TTE. The opposite is also possible in cases in where a saver earns a pension in a TEE Member State and receives it in an EET Member State. In such a case the pension may be subject to double taxation. Bilateral tax conventions need to be analysed in order to avoid no-tax or double-tax situations.

4 Importance of costs

For a PEPP-saver, an important issue is the total sum that can be paid out after retirement. There are three elements affecting the outcome (in addition to the level of the annual contribution), namely tax-benefits or bonuses, annual yield and costs. Pension savings occur over a long period of time. In such cases the impact of compound-interest is significant. Costs (annual, performance, management, etc.) could be considered as negative investments, and via the compound-interest, they can represent significant amounts over the savings period.

For example, the table below shows what the cumulated capital would be assuming: annual yield of 3 %, a very low annual cost of 0.5 %, and annual investment of €5 000.

<table>
<thead>
<tr>
<th>Year</th>
<th>Invested capital</th>
<th>Annual saving</th>
<th>Cumulated capital without costs</th>
<th>Cumulated capital with costs (0.5 %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>5 000</td>
<td>5 000</td>
<td>5 000</td>
<td>5 000</td>
</tr>
<tr>
<td>1</td>
<td>10 000</td>
<td>5 000</td>
<td>10 150</td>
<td>10 139</td>
</tr>
<tr>
<td>...</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>105 000</td>
<td>5 000</td>
<td>143 382</td>
<td>135 700</td>
</tr>
</tbody>
</table>

Source: Table compiled by the author.

Consequently, 21 years of annual payments of €5 000 correspond to a total investment of €105 000. With an annual investment yield of 3 %, the investment has generated €38 382 in interest income. Assuming that an annual fee of 0.5 % is charged by the service-provider, the interest income would be €30 700. This represents a 20 % lower interest income compared with a no costs scenario. Assuming higher annual costs of 1 % and 2 %, the difference becomes clearer. The total accrued capital would be respectively €128 510.

20 Signed but not in force with IRL, MT, ES and the UK.
30 For details of the various taxation options, see Table 1 of this study.
and €115 483. The interest rate difference compared to a no-cost calculation would be €14 872 and €27 899. Higher costs can reduce the total outcome significantly, especially during prolonged periods of lower investment returns. More information regarding the costs and their impact can be found in other publications such as the 'Study on the position of savers in private pension products',\(^{31}\) 'Pension scheme charges',\(^{32}\) and 'Costs and charges of IORPs'.\(^{33}\)

**Figure 4 – Effect of annual costs on the cumulated capital, in €**

![Graph showing the effect of annual costs on the cumulated capital.](image)

Source: EPRS.

\(^{31}\) *Study on the position of savers in private pension products*, Oxera, January 2013.


\(^{33}\) *Costs and Charges of IORPs*, EIOPA, January 2015.
Therefore, a key success factor for a PEPP is the management of costs. The need for a PEPP service provider to be able to open national compartments in other Member States based on clients’ requests will incur additional costs (e.g. translation, legal and management costs).

The PEPP provider must be more cost-effective than a national PPP-provider (or provide better yields) in order to be able to provide pensions products with higher or equal returns (compared with national competing products).

5 European added value – impact channels and value added

5.1 European added value

The PEPP would contribute to the achievement of the capital markets union. Funds invested over long periods would create a new funding source for long term investments, thereby contributing to economic growth and increased employment levels. The availability of long-term funds would also deepen capital markets and provide an alternative source of corporate finance, thus reducing the reliance on bank loans. Long-

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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 study on the position of savers in private pension products.34

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34 Oxera Study, 2013.
term investments should normally produce higher yields than short term investments, which would generate a higher retirement income for the savers.

The need to increase second and third pillar pensions is widely recognised, however the second and third pillar markets are not equally developed across the EU, preventing many EU citizens from having appropriate access to quality pension products. Via the PEPP, cross-border barriers could be reduced, thus enabling EU citizens to benefit from improved quality, more reliable products and lower prices (on account of greater cross-border competition); while producers should benefit from the economies of scale effect. The European Commission communication of 19 April 2001 on 'The elimination of tax obstacles to the cross-border provision of occupational pensions'\textsuperscript{35} states that: 'A fully functioning single market for occupational pensions is essential to ensure that citizens are able to exercise their rights to free movement enshrined in the EC Treaty and thus to enhance labour mobility'. The statement was made in the context of second pillar pensions but is also true regarding the third pillar pensions.

The European Political Strategy Centre note on PEPP states that:
'With the EU market size currently standing at over 1 trillion euro, the potential efficiency gains to be achieved through economies of scale and risk diversification thanks to the removal of national barriers can be expected to be considerable. Economies of scale for pension funds with respect to membership and assets under management are well documented in a number of countries and lead to lower fees. It is estimated that decreasing asset management costs by 0.25 % could see pensions increase by 10 % over a 40 year horizon'.\textsuperscript{36}

The impact assessment accompanying the PEPP proposal states that:
'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 significantly 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'.\textsuperscript{37}

Finally, according to the above-mentioned Ernst & Young study:
'the additional market potential if a PEPP available in all EU Member States allowed consumers to effectively reach the current product technology frontier (i.e. meet the market performance of the Riester product) ranges from EUR 0.4 trillion to EUR 1 trillion. It is expected that on average the increase would amount to EUR 0.7 trillion. This estimate

\textsuperscript{36} Filling the Pensions Gap and Refinancing the Economy, European Political Strategy Centre, June 2017, p. 6.
\textsuperscript{37} European Commission staff working document, SWD/2017/0243 final, p. 34.
is based on current EU financial assets, i.e. it does not make any assumption about the
growth of overall financial assets in the future’.\textsuperscript{38}

It should be noted that it has been assumed that the PEPP product would have product
characteristics (including but not restricted to taxation) similar to those of the most
competitive existing national PPP. In the event that the PEPP is less attractive than the
most attractive national PPP, the total increase will be lower. A possible substitution
effect i.e. a possible move from second pillar to third pillar, or from first pillar to third
pillar has not been analysed, and has not therefore been included in the figures quoted
above.

\subsection*{5.2 Generosity of first and second pillar systems}

Clearly pension systems need to be considered holistically, looking at the support
provided across all three pillars. Indeed, a truly full picture of the adequacy of retirement
provision would look even more widely, for instance, at the different cost of living in the
various Member States, minimum income support, benefits in kind (e.g. free health and
long-term care) and wealth (e.g. housing). The Commission’s Pension Adequacy Report
2015 (PAR 2015) mentioned earlier seeks to take a comprehensive look at the adequacy
of retirement provision.

As the PAR 2015 makes clear, public pension schemes (pillar I) funded on a PAYG basis
are, and will remain, the most important source of retirement income for most EU
citizens. Nonetheless they are typically decreasing in generosity for the future, as already
mentioned. There are many different measures using a variety of methods and data for
comparing pension adequacy.\textsuperscript{39} When it comes to choosing a single measure of adequacy
for the purposes of comparison, the aggregate replacement ratio is generally considered
the best option. The aggregate replacement ratio\textsuperscript{40} is the median individual gross pension,
including old-age and other pension benefits, of people aged 65 to 74 relative to the
median individual gross earnings of people aged 50 to 59, excluding other social benefits.
The table below, extracted from Eurostat, is based on the EU-SILC survey and sets this out
for each of the EU28 together with the EU28 average, for 2016 – the most recent year for
which data is available.

\begin{table}
\centering
\begin{tabular}{|c|c|c|}
\hline
Country & Aggregate Replacement Ratio & Notes \\
\hline
EU28 Average & 0.75 & \\
\hline
\end{tabular}
\end{table}

\textsuperscript{38} Study on the \textit{feasibility of a European Personal Pension Framework}, Ernst & Young, June 2017, p. 258.

\textsuperscript{39} More information on pension adequacy, including an annex detailing some of the key measures of adequacy, is available in the EPRS briefing, \textit{European Union pension systems: adequate and sustainable?}, European Parliament, November 2015.

\textsuperscript{40} See \textit{Eurostat}.  

23
Table 3 – Ratio between income from pensions of persons aged between 65 and 74 years and income from work of persons aged between 50 and 59 years, in 2016

<table>
<thead>
<tr>
<th>EU28 average and EU Member States</th>
<th>Ratio of income</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Union (28 countries)</td>
<td>0.58</td>
</tr>
<tr>
<td>Belgium</td>
<td>0.48</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>0.45</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>0.50</td>
</tr>
<tr>
<td>Denmark</td>
<td>0.47</td>
</tr>
<tr>
<td>Germany</td>
<td>0.46</td>
</tr>
<tr>
<td>Estonia</td>
<td>0.45</td>
</tr>
<tr>
<td>Ireland</td>
<td>0.35</td>
</tr>
<tr>
<td>Greece</td>
<td>0.63</td>
</tr>
<tr>
<td>Spain</td>
<td>0.66</td>
</tr>
<tr>
<td>France</td>
<td>0.68</td>
</tr>
<tr>
<td>Croatia</td>
<td>0.39</td>
</tr>
<tr>
<td>Italy</td>
<td>0.69</td>
</tr>
<tr>
<td>Cyprus</td>
<td>0.44</td>
</tr>
<tr>
<td>Latvia</td>
<td>0.42</td>
</tr>
<tr>
<td>Lithuania</td>
<td>0.45</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>0.88</td>
</tr>
<tr>
<td>Hungary</td>
<td>0.67</td>
</tr>
<tr>
<td>Malta</td>
<td>0.54</td>
</tr>
<tr>
<td>Netherlands</td>
<td>0.50</td>
</tr>
<tr>
<td>Austria</td>
<td>0.62</td>
</tr>
<tr>
<td>Poland</td>
<td>0.62</td>
</tr>
<tr>
<td>Portugal</td>
<td>0.64</td>
</tr>
<tr>
<td>Romania</td>
<td>0.66</td>
</tr>
<tr>
<td>Slovenia</td>
<td>0.47</td>
</tr>
<tr>
<td>Slovakia</td>
<td>0.62</td>
</tr>
<tr>
<td>Finland</td>
<td>0.53</td>
</tr>
<tr>
<td>Sweden</td>
<td>0.57</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.53</td>
</tr>
</tbody>
</table>


The data in the above table shows that the aggregate replacement ratio in 2016 ranges from a high of 0.88 in Luxembourg to a low of 0.35 for Ireland. Luxembourg is very much an outlier with the next highest aggregate replacement ratio found in Italy, at 0.69. France, Hungary, Spain and Romania are all above 0.65. At the other end of the scale, Croatia, at 0.39, is the second lowest and the only other country (with the lowest, Ireland) below 0.40. Other countries with low aggregate replacement ratios in 2016 include Latvia (0.42), Cyprus (0.44), Lithuania, Estonia and Bulgaria (all three on 0.45) and Germany (0.46). The EU28 average is 0.58.
Note that, in common with all measures, there are pros and cons to the methodology used for the aggregate replacement ratio. As this measure compares the incomes of people aged between 50 and 59 with those of older people aged between 65 and 74, changes in the ratio may be driven by changes in the incomes of people aged 50 to 59, as well as those aged 65 to 74. So, for instance, the aggregate replacement ratio may improve if the incomes of people aged from 50 to 59 fall (e.g. owing to the financial crisis impacting on the incomes of working age people more those of pensioners) and equally the ratio may worsen when incomes of people aged 50 to 59 rise (e.g. during economic booms where wages may rise faster than pensions). This is why a wide range of indicators are used to seek to provide a comprehensive picture of pension adequacy.

Nonetheless, the aggregate replacement ratio is considered to be a key measure of pension adequacy and generally accepted as the best option should just a single measure be required.

Occupational pensions (pillar II) can provide an important complementary source of retirement income for some people in some Member States, though most of them have comparatively little, if any, occupational pension provision. According to EIOPA’s Financial Stability Report of December 2017, the United Kingdom (45.5 %) and the Netherlands (35.9 %) between them accounted for over 80 % of reported pension fund assets in the EU. The report noted that ‘both the UK and the Netherlands are providing their citizens with relatively modest flat-rate state pensions, which are complemented by significant private pension provisions’.

The next highest share was in Germany with 6.2 %, followed by Italy (3.4 %) and Ireland (2.9 %). Data from the OECD (which includes insurance-based occupational pensions) covering occupational pension plan assets as a percentage of the respective countries’ GDP in selected EU countries, shows that Denmark and the Netherlands have assets of over or around 150 % of GDP while the UK has approximately 100 %. Finland and Ireland both have a little over 50 % with Sweden at around 40 % and Portugal, France, Germany, Austria, Italy and Belgium all having between 5 % and 10 %.

When looking broadly at pension adequacy, benefits in kind and the wider social system are also important. For instance, health and long-term care costs can be a key expense for older people, so the level of contributions older people need to make to these costs can impact on the adequacy of their retirement provision. National health and long-term care systems vary considerably in their form and generosity and are also themselves coming under pressure from demographic ageing, as with the pension systems. Health services, for example, can be residency-based and funded from general taxation in some Member States but based on compulsory insurance in others. Co-payments and the medical conditions and services covered vary enormously too.

Wealth (rather than just income) is also an area that a comprehensive look at retirement provision should consider. An obvious example is housing wealth. Once again Member

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43 For more on occupational pensions see, Prospects for occupational pensions in the European Union, EPRS, September 2015.
44 Joint report on health care and long-term care systems & fiscal sustainability, European Commission, October 2016.
States vary – from those where renting is common to those with high levels of home ownership. According to Eurostat 95.1% of households in Romania are living in owner-occupied property with no outstanding loan or mortgage compared to just 8% of households in the Netherlands. One may reasonably assume that those homeowners will save outright on rent during their retirements or be able to rent their property out for extra income. They may also be able to release capital by selling and downsizing to buy or rent a cheaper property. Certain countries (e.g. Belgium) also have a relatively well-developed market in ‘reverse mortgages’ which allow older people to release some equity from their property without having to sell it immediately.

5.3 Could improvements in third pillar pensions increase the risk of reductions in first pillar support?

Broadly speaking, action to improve the sustainability of PAYG public pension schemes (pillar I) has already been taken, as noted in Section 1 (background). Hence reductions in pillar I costs are already in train and will become more significant as they gradually come into effect. Their impact on adequacy will to a large extent depend on the extent to which people are able and willing to work more and longer to compensate for later retirement ages and more stringent conditions to qualify for a full pension. However, income from occupational pension schemes (pillar II) and personal pensions (pillar III) may mitigate this to some extent in four Member States, with public-funded pillar Ib schemes expected to provide some mitigation in eight Member States (see Figure 1).

In terms of the current individual importance of the three pension pillars at EU aggregate level, the personal pension market (pillar III) is by far the least important. Pillar III pension savings are estimated to be worth only around €0.7 trillion currently compared to around €7.5 trillion – over 10 times as much – in existing occupational pensions entitlements. Meanwhile, EU expenditure on public pensions was around 11.3% of EU GDP in 2013. Indeed the 2015 PAR notes that public PAYG pensions (i.e. pillar I pensions) are the main provider of pension income across the EU.

Of course the relative importance of the three pillars varies considerably between Member States, depending on the design of their pension system. According to the 2015 PAR, using one adequacy metric (theoretical replacement rates – TRRs), occupational pensions contribute more than 20% to the TRR in France, the Netherlands, Sweden and the UK. It also notes that the proportion of income coming from occupational pensions is lower for lower earners, since the PAYG pillar I scheme typically has redistributive features to help support lower earners more.

So whilst a stronger occupational pension sector (pillar II) naturally plays a stronger role in overall pension support, as least proportionately, pillar I remains the most important element for most people, especially lower earners. There seems to be little evidence currently that pillar III pensions lead to lower pillar I pensions, which is perhaps not surprising given their small scale. Even if they grow significantly (to €1.4 trillion by 2030 or higher still to €2.1 trillion, if the PEPP is a success, according to the Commission PEPP

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45 See Distribution of population by tenure status, type of household and income group – EU-SILC survey, Eurostat, 15 February 2018.
46 See Framework for a pan-European personal pension product (PEPP), EPRS, October 2017.
47 See PAR, 2015, p. 125.
impact assessment) they will still be dwarfed by pillars I and II. This suggests they are unlikely to have any significant impact on decisions to further reduce the costs of public pillar I pension schemes, at least on aggregate.

6 Conclusions

There exists clear evidence for the European added value to be gained in the context of the PEPP. The PEPP contributes to the free movement of people by facilitating cross-border mobility, providing a simpler pension product for people who have worked or plan to work in several Member States. The economic dimension derives from the fact that a supranational operation delivers larger benefits to Members States (increased voluntary pension savings), savers (better and cheaper products, larger variety of products) and service providers (larger customer base, simplified legislation, fewer cross-border transaction costs).

Indirect impacts and possible leverage achieved through the better allocation of financial resources in the context of the capital market union has the potential to enhance Member States' economic activity thus contributing to GDP growth, which in turn impacts positively on the sustainability of Member States' fiscal situation, allowing the sustainable financing of pillar 1 pensions.

High quality supervision is important to ensure that the promise given via the EU quality-label granted for the PEPP holds. Supervision needs to ensure that service providers have adequate capacity to manage savers' funds, and that service providers' fund management systems and controls are robust. A recent case in Sweden (Allra Sverige AB)48 provides a good example of the risks of insufficient supervision. According to the Swedish pensions agency, Allra has transferred SEK 150 million worth of Swedes' savings to a subsidiary in Dubai. Swedish radio reported that 'in a statement given to the Stockholm County Court the pensions agency claims that Allra had started its Dubai subsidiary with the sole purpose of transferring savers' money to the company's owners. According to the statement, the Dubai company received nearly SEK 150 million for buying securities for three of Allra's funds within the PPM system, under which Swedes are given tax incentives to save privately to top up their pensions'. The Swedish pensions agency has expelled the fund from the PPM (premium pension system) system.

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Annex 1 – Motion for a resolution

MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION with recommendations to the Commission on tax treatment of pension products, including the pan-European Personal Pension Product (2018/2002(INL))

The European Parliament,

– having regard to Article 225 of the Treaty on the Functioning of the European Union,


– having regard to the Commission Recommendation on the tax treatment of personal pension products, including the pan-European Personal Pension Product (C(2017)4393),

– having regard to Rules 46 and 52 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A8-0000/2018),

A. whereas the internal market for personal pension products remains highly fragmented, in particular concerning tax reliefs;

B. whereas the Study on the feasibility of a European Personal Pension Framework of June 2017 (FISMA/2015/146(02)/D) demonstrates that fiscal incentives are key to the uptake of PEPP;

C. whereas Member States have exclusive competence in the area of direct taxation;

D. whereas in the internal market all providers and products must be treated equally, regardless of nationality or Member State of origin;

1. Calls on the Council, with a view to enhancing the uptake of the pan-European Personal Pension Product (PEPP), to elaborate proposals regarding incentives for PEPP savers;

2. Suggests for the following approaches to be considered:

   - granting the same tax relief to PEPP as the one granted to national personal pension products, even in cases where PEPP features do not fully match all the national criteria;

   - granting a specific tax relief to PEPP, harmonised at Union level, to be laid down in a multilateral tax agreement between Member States;

   - granting a specific subsidy or premium to PEPP savers, in the form of a fixed amount or fixed percentage;

3. Instructs its President to forward this resolution and the accompanying recommendations to the Commission and the Council.
Annex 2 – Pension glossary and taxonomy

**Adequacy:** the adequacy of pensions is measured by their ability to prevent poverty, the degree to which they match the level of pre-retirement income and how they compare with the average incomes of people below pensionable age.

**Funded (i.e. pre-funded) schemes:** these are pensions in which contributions are invested over time and then used to pay pension benefits in the future. Most occupational pensions are funded.

**Pay-as-you-go (PAYG):** revenue from current contributions is used directly to pay for current retirement benefits, so they are not pre-funded, barring, in some cases, small reserve funds. Most public pension schemes are PAYG.

**Sustainability:** the sustainability of pensions relates to the fiscal and financial balance between revenues and liabilities (and the ratio of workers-contributors to pensioners-beneficiaries).

**Taxonomy:** there is no single agreed detailed taxonomy for pensions, but set out below is a typical three-pillar approach, used in this note.\(^49\)

'**First pillar**' (public) pensions: these are public statutory pensions administered by the state and usually financed from social insurance contributions and/or general tax revenues on a pay-as-you-go (PAYG) basis (i.e. revenue from current contributions is used directly to pay for current retirement benefits). In central and eastern European Member States in particular, statutory mandatory funded individual plans, (pillar Ib pensions), have been introduced alongside pillar I.

'**Second pillar**' (occupational) pensions: these are private supplementary plans linked to an employment relationship. Contributions are made by employers and/or employees, often with state support via tax advantages. These plans may be mandatory or quasi-mandatory and commonly established via employment contracts or by social partners in sector- or profession-based collective agreements. They are normally pre-funded. They qualify as either 'defined benefit' (DB – where the pension is linked to the period of service and salary level), 'defined contribution' (DC – where the pension is based on contributions paid and investment returns, less costs), or hybrid schemes (DB/DC – combining some features of both, e.g. defined contribution, but with minimum guarantees).

'**Third pillar**' (personal) pensions: these are personal pensions, i.e. pre-funded private voluntary supplementary plans, in which contributions are invested in an individual account managed by a pension fund or financial institution. They may be tax-incentivised.

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\(^49\) More details on pension classifications can be found in *Pension Schemes*, Policy Department A for Economic and Scientific Policy, European Parliament, August 2014.
This European added value assessment, prepared for the European Parliament’s Committee on Economic and Monetary Affairs (ECON), analyses the added value of a pan-European pension product, in particular from the taxation viewpoint. It presents the issues that led to the PEPP proposal being made and provides a short overview of key stakeholders’ opinions and existing studies. Moreover it considers the question of PEPP taxation and the impact of costs on final pensions. The analysis concludes by identifying the potential European added value that could be achieved by means of the PEPP proposal.