

**MEMO# 13298**

March 23, 2001

## **EUROPEAN PARLIAMENTARY RAPPORTEUR ISSUES DRAFT REPORT ON THE PROPOSED EU DIRECTIVE ON OCCUPATIONAL PENSIONS**

[13298] March 23, 2001 TO: INTERNATIONAL COMMITTEE No. 22-01 RE: EUROPEAN PARLIAMENTARY RAPPORTEUR ISSUES DRAFT REPORT ON THE PROPOSED EU DIRECTIVE ON OCCUPATIONAL PENSIONS On March 21, 2001, a rapporteur of the European Parliament submitted for discussion to the European Parliament's Economic and Monetary Affairs Committee a draft report on the proposal for a directive on occupational pensions. We understand that the rapporteur's report generally was well received by members of the Committee and there will be further discussions at the Committee's April 26 meeting before the report is voted upon at a plenary session of the Parliament. The rapporteur hopes to complete the first reading of the directive in Parliament by July.<sup>1</sup> This memorandum provides a general overview of the rapporteur's draft report, a copy of which is attached, and highlights some of the proposed amendments that may be of interest to members. The draft report is in two parts -- an explanatory statement of the report and a description of the 47 amendments to the European Commission's proposed directive, which was issued in October 2000.<sup>2</sup> Under the Commission's proposal, the proposed directive would cover institutions that operate on a funded basis for the sole purpose of providing retirement benefits (IORPs). The directive would impose certain conditions for operations of IORPs, rules for investment of IORPs, and rules permitting the cross-border management of occupational pension schemes. Generally, the draft report attempts to balance the social concerns related to pensions, including security for pensioners, with ensuring efficient management of pension assets. The rapporteur emphasizes the importance of pension reform and is of the view that the task of the European Union is to create the conditions under which retirement systems can develop effectively in a single internal market and to ensure that the varying arrangements in the 1 The European Commission's companion communication on taxation of pensions is expected to be published in the week of April 9, 2001. The rapporteur will likely wait for the publication of the communication before submitting his draft report to the plenary session for a vote. 2 See Memorandum to International Committee No. 38-00 (Oct. 26, 2000). We are attaching the final version of the Commission's proposal, which renumbers and reorganizes provisions in a version that was attached to the October memorandum. 2member states do not give rise to obstacles to the mobility of workers and capital and to cross- border activities. In this regard, the rapporteur has five main objectives with respect to an EU directive on occupational pensions. First, the directive should guarantee the protection of beneficiaries and the security of pensions by imposing strict supervisory rules and provisions for participants to receive comprehensive

information. Second, the directive should permit institutions to invest assets efficiently on the basis of the prudent person rule. Third, the directive should facilitate cross border activity of institutions and permit workers to benefit from mobility within the internal market without sacrificing their pension benefits. Fourth, the directive should treat service providers equally and permit institutions to seek the services of an asset manager or custodian established in another member state. Finally, the directive should require costs to be transparent. We briefly describe below the amendments proposed in the draft report that would implement these objectives.

**Biometric Risk** Although the Commission's proposed directive does not require coverage of biometric risks (risks of longevity, disability, and premature death), there has been considerable discussion of this issue since the Commission issued its proposal. To force participants to consider carefully provisions for their old age, the draft report would require member states to ensure that IORPs offer participants, as additional benefits, the option of an annuity upon requirement, disability coverage, and provisions for survivors if the sponsors (employers) of the pension schemes do not already provide these benefits. The costs of these benefits must be identified separately and clearly and must not be contingent on the sex or health of an individual. The draft report would permit IORPs to provide the biometric coverage themselves for a disclosed fee or to arrange for a contract with another service provider (e.g., insurance company) to provide the biometric coverage. For example, if an IORP does not provide coverage for longevity, the IORP would be required to provide participants upon retirement with an option to invest the capital with another provider that would provide benefits in the form of an annuity. Participants, however, would not be required to take the annuity option. Similarly, if a beneficiary seeks a guarantee of the contributions made to the pension scheme, the IORP also either would have to provide the guarantee or arrange for a guarantee through another provider. The draft report proposes that the costs associated with providing coverage for biometric risks be clearly disclosed to participants. The draft report would amend the directive to require that the calculation of the premium for biometric risk coverage not be based on individual risk assessments but only based on the investment policy of the IORP. The draft report notes that speculative commitments would be likely to increase the risk premiums to be paid by participants whereas strict compliance with the prudent person rule would be reflected in correspondingly low premiums. It is unclear how an insurance company would be able to calculate the premium based on an IORP's compliance or deviance from the prudent person standard.

**Investment Rules** The Commission's proposed directive would impose a prudent person standard on IORPs and would prohibit member states from requiring IORPs to invest in certain categories of assets. Although the directive would allow member states to impose more detailed rules (including quantitative investment limits) on pension funds, the proposal would limit the restrictions that member states may maintain. Specifically, under the Commission's proposed directive, IORPs must be permitted to invest in shares and corporate bonds up to 70% of the assets, risk capital markets,<sup>3</sup> and assets denominated in non-matching currencies to cover at least 30% of their technical provisions.<sup>4</sup> The draft report supports the Commission's proposed prudent person rule as the appropriate standard for investing pension assets. The report would limit the Commission's proposal that would allow member states to impose quantitative investment restrictions by proposing a ten-year period in which member states would be required to phase out quantitative investment limits.

**Treatment of Service Providers** The draft report takes the view that the directive should establish a level playing field for all service providers in competing for the occupational pensions business. Specifically, the report would leave to insurance companies and not the individual member states whether insurance companies could operate within the scope of the occupational pensions directive. The draft report further would amend the proposed directive to provide insurance companies the choice of setting up a separate legal entity that would be subject

to all provisions of the directive or of managing the pension business by establishing a separate clearing agency that would be subject to the provisions of the directive governing supervision and investment. The draft report also proposes to eliminate a provision in the directive that would allow member states to make the conditions of operation of an IORP subject to other requirements for the interests of participants and beneficiaries. Taxation of Pension Schemes The draft report acknowledges that uniform tax principles are necessary for portability of pensions and mobility within the European Union to become a reality. Although recognizing that the amount of taxation is a matter for the member states, the draft report encourages member states to transition into deferred taxation (Exempt, Exempt, Tax system) to prevent the double taxation or non-taxation of contributions and benefits. The draft report also is of the view that member states must comply with the principles laid down in the EU Treaty and eliminate discriminatory tax practices imposed on foreign service providers and pension 3 The Commission's proposed directive defines "risk capital markets" as markets providing equity financing to a company during its early growth stages. See Article 6(i) of the Commission's proposed directive. 4 IORPs that cover biometric risks and/or provide guarantees of investment performance or level of benefits must establish sufficient technical provisions, and member states generally must require IORPs to have sufficient assets to cover the technical provisions. See Articles 15 and 16 of the Commission's proposed directive. 4 contributions by nationals of other EU member states. The draft report maintains that these measures can help develop further the functioning of an internal market in supplementary pensions. Cross-border The draft report proposes a couple of amendments to facilitate cross-border activities. First, although the report proposes to retain the provision that would permit member states to exclude from the scope of the directive schemes with fewer than 100 participants or beneficiaries, the report proposes to require members states to allow these small institutions to engage asset managers or custodians that are established in another member state. Second, the draft report proposes to eliminate the stricter rules regarding coverage of liabilities for IORPs that are engaged in cross-border activities. Specifically, in keeping with the principle of equal treatment, the draft report proposes to delete the Commission's provision that would require that the technical provisions of IORPs be fully funded when they engage in cross-border activity. The Institute will provide comments on the proposal to members of the European Parliament and to the rapporteur of the directive on occupational pensions. Please review the attached report and provide me with any comments you may have on the report, especially with respect to the biometric risk coverage discussions. If you have any questions, please contact me at (202) 326-5810 or jchoi@ici.org. Jennifer S. Choi Assistant Counsel Attachments Attachment no. 1 (in .pdf format)