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## PEPP – Towards a Harmonized European Legislative Framework for Personal Pensions

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<sup>4</sup> The views expressed in these materials are those of the authors and not necessarily those of Franklin Templeton Investments and First Pensions.

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**List of Abbreviations**

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Managers Directive
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
ECB Regulation	European Central Bank Regulation
EBA Regulation	European Banking Authority Regulation
EFAMA	European Fund and Asset Management Association
EIOPA	European Insurance and Occupational Pensions Authority
EIOPA Regulation	European Insurance and Occupational Pensions Authority Regulation
ELTIF	European Long-Term Investment Fund
ELTIFR	European Long-Term Investment Fund Regulation
ESFS	European System of Financial Supervisory
ESMA	European Securities and Markets Authority
ESMA Regulation	European Securities and Markets Authority Regulation
ESRB Regulation	European Systemic Risk Board Regulation
EuSEF	European Social Entrepreneurship Funds
EuSEFR	EuSEF Regulation

EuVECAR	EuVECA Regulation
IDD	Insurance Distribution Directive
IORP	Institutions for Occupational Retirement Provision
IORPD II	Institutions for Occupational Retirement Provision Directive
IOSCO	International Organization of Securities Commissions
KIID	Key Investor Information Document
MiFID II	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
OECD	Organisation for Economic Cooperation and Development
PEPP	Pan-European Personal Pension product
PPP	Personal pension products
PRIPs	Packaged Retail Investment Products
PRIIPs	Packaged Retail and Insurance-based Investment Products
PRIIPSR	PRIIPS-Regulation (Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs))
Solvency II	Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UCI	Undertaking for Collective Investments
UCITS	Undertakings for Collective Investment in Transferable Securities
UCITSD V	Undertakings for Collective Investment in Transferable Securities Directive

## Executive Summary

In the last couple of years questions arose how the PEPP should ideally be regulated and the European Commission and various interest groups, till now, have not found a solution for all possible problems in developing a common regulatory framework yet.

For that purpose, this Report focused on how the PEPP could ideally be regulated. It discussed the PEPP and the PPP, how PEPPs as a ‘wrapper product’ should be defined and how a PEPP (product) passport under a future PEPP Regulation could be established. Furthermore, this Report focused on the possible regulation for PEPP providers/distributors, depositaries/custodians, the position of consumers, the standardization of PEPP/PPP product regulation and sales regulation. It concluded by reviewing possible tax barriers related to the PEPP and migrating PEPP holders and the lessons that can be learned from the existing (personal) pension framework in Sweden, the UK and the US.

## PEPPs versus PPPs

Reviewing the latest policy discussion, PPPs were not to be further considered as the 29<sup>th</sup> regime as it was perceived by the industry and EIOPA as too difficult to accomplish given the significant divergence in national legislative frameworks in the European market of personal pensions.<sup>5</sup> This Report, thus, focused on the PEPP under an optional European regime.

## The PEPP as ‘Wrapper Product’– Establishing a Definition

It was considered that the only viable way to establish a harmonized PEPP regime is by defining and regulating PEPPs as wrappers of existing (EEA) third-pillar pension products. The product would be required to comply with ‘common features’ of voluntary personal pension plans and fulfill additional mandatory elements, such as a default investment option, limited investment choices and flexible elements that include guarantees, a cap of cost and charges and switching between providers. Only allowing EEA regulated third-pillar pension products would ensure that PEPP providers cannot enter into regulatory arbitrage by choosing a less well regulated underlying national product as part of a PEPP. The European legislator, however, could be of the opinion that the mandatory and flexible elements provide enough consumer protection as to allow every single type of underlying third-pillar product to be ‘wrapped’ into the PEPP product passport. In addition, EIOPA could opt for a different ‘29th’ or ‘second’ regime in which the PEPP as ‘standard’ EU pension plan may be optionally implemented by EEA Member States into their national first pillar b, second pillar

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<sup>5</sup>. See the response of Arbeitsgemeinschaft für betriebliche Alstervorsorg to Consultation Paper 16-001: European Insurance and Occupational Pensions Authority, *Summary of Comments on Consultation Paper 16-001*, 14 July 2016, EIOPA-BoS-16/467, 28.

‘occupational’ pension laws.<sup>6</sup> This would gradually lead to a standardization of pension products throughout the first, second and third pension pillars in Europe in a so-called ‘pensions union’.<sup>7</sup> PEPP could even be part of extending the UCITS global brand success story to other EEA (third-pillar) retirement products.<sup>8</sup>

### **The PEPP (Product) Passport under a PEPP Regulation**

EIOPA indicated in several policy documents that it believes that the internal market for PEPPs would be substantially enhanced if a PEPP product passport would be introduced.<sup>9</sup>

To facilitate the ‘mutual recognition’ approach and overcome ‘risk asymmetry’, the European passport was proposed in this Report to be based upon a common European substantive legislative and supervisory framework. In line with recent legal initiatives, including the ELTIFR, EuSEFR, EuVECAR and the proposed MMFR, it would be logical that the PEPP initiative will also be established as a regulation. The regulation as legislative instrument prevents Member States from ‘goldplating’ the PEPP initiative that could result in the hindrance of an ‘internal market for PEPPs’. The Level 1 harmonization of PEPP providers, distributors, products and sales regulation may be further complemented by legislative implementing acts adopted by the European Commission (Level 2) or any technical measures/guidelines adopted by ESAs. Applying the European System of Financial Supervision introduced in 2011 to PEPPs would ensure that the PEPP initiative would also be adequately enforced by home/host Member States and the supranational ESAs.

### **PEPP – Governance of the PEPP Initiative – Intermediary, Product & Sales Regulation**

This Report addressed the full governance of the PEPP involving intermediaries (PEPP provider and distributor), the depositary, the position of consumers, the PEPP product and sales/disclosure regulation.<sup>10</sup>

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<sup>6</sup> H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 20, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>7</sup> H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 20, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>8</sup> C. D. Christian, *UCITS outside Europe* 450 (D. Frase ed., Sweet & Maxwell 2011).

<sup>9</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006.

<sup>10</sup> See for the regulation financial intermediaries, in particular depositaries: Hooghiemstra, S.N., *Depositaries in European Investment Law: Towards Harmonization in Europe*, Phd 2017 (forthcoming); A. Byrne, A., D. Harrison & D. Blake, *Defined Contribution Pensions: Dealing with the Reluctant Investor: Innovation and Governance in DC Pension Investment*, [http://www.pensions-institute.org/reports/PI\\_DC\\_Investment\\_Final.pdf](http://www.pensions-institute.org/reports/PI_DC_Investment_Final.pdf) (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 9-10; Cf. Organisation for Economic Co-operation and Development, *Guidelines on Pension Fund Governance*, <http://www.oecd.org/dataoecd/18/52/34799965.pdf> (access 21 December 2016); International Organisation of Pension Supervisors, *Supervising default investment funds*. IOPS Working Papers on Effective Pensions Supervision, No.18 (2012).



EIOPA has throughout the PEPP consultations considered two approaches to regulate PEPP providers.<sup>11</sup> EIOPA originally considered a stand-alone authorization regime<sup>12</sup> with specific conduct of business<sup>13</sup> and prudential requirements for PEPP providers to ensure a level-playing field.<sup>14</sup> The stand-alone regime was intended to allow not only ‘EEA PEPP providers’ but also PEPP providers not authorized under any, EEA legislation to provide PEPPs. This would ensure that such providers would not fall in an authorization gap and that a level playing field would be ensured that would lead to higher consumer protection provided that those providers would fulfill an ‘equivalence assessment’ ascertaining the comparability with providers under the EEA sectoral legislation.<sup>15</sup> The large majority of the stakeholders, however, responded that regulatory arbitrage should be prevented and that providers should only be allowed to enter the PEPP market that are authorized under existing EEA legislation.<sup>16</sup> Moreover, a separate authorization regime would lead to additional regulatory burden that would discourage EEA financial intermediaries from becoming PEPP providers, because of the cost implications.<sup>17</sup> For this reason, EIOPA changed its view and came to the conclusion that current sectoral authorization regimes should be used and that the provision of PEPP should be limited to those providers authorized under relevant European legislation.<sup>18</sup> The sectoral-approach, however, has as a consequence that only those PEPPs may be offered for which the provider is authorized according to the current legislation for the respective sector.

The proposed PEPP provider regime allows EEA regulated intermediaries that already offer third-pillar retirement products to be eligible as a PEPP provider. The authorization includes a

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<sup>11</sup> See European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 33,

[https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf).

<sup>12</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 11-12.

<sup>13</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 11-12.

<sup>14</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 11-12.

<sup>15</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 12.

<sup>16</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>17</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 33,

[https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf);

European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>18</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

European (Intermediary) passport under which the PEPP initiative would allow EEA intermediaries to be active on a cross-border basis. For the provision of a PEPP, PEPP providers may only offer those PEPPs that contain an underlying third-pillar retirement product for which they are authorized under EEA sectoral legislation.<sup>19</sup> Consequently, the authorization of a PEPP provider limits the range of PEPPs that may be offered to consumers in the accumulation phase, as well as, the payout solution in the decumulation phase.

Distributors under the proposal in this Report can be part of the PEPP provider, an agent of a PEPP provider or a third party.<sup>20</sup> Within the context of the PRIIPR, a distributor could be defined under the PEPP initiative as ‘a person advising on, or selling<sup>21</sup>, PEPPs’.<sup>22</sup> This definition would capture AIFMs and UCITS ManCos as PEPP providers that are under the AIFMD and UCITS V authorized to market AIF/UCITS units to consumers. In addition, this definition would also include investment firms/credit institutions under MiFID II and insurance companies/undertakings under the IDD. The advantage of the proposed definition is that both PEPP providers and distributors would in their capacity of distributor have a European passport under the respective European legislative acts.<sup>23</sup>

If a sector-specific approach for the use of depositaries would be pursued then no considerations would have to be made whether or not a depositary should be required to be appointed for PEPPs as this issue is already solved at the level of the sector specific legislations. The sectoral approach also prevents a ‘double depositary requirement’ as this approach, for instance, would not require insurance undertakings acting as PEPP providers to appoint a depositary for life insurances offered. Underlying investment options that would include UCITS or (retail) AIFs, however, would require the appointment of a depositary.

Including a sector-specific requirement based on the underlying third-pillar pension product on the use of depositaries reflects, indeed, the business model of PEPPs the best. Extending the

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<sup>19</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>20</sup> International Organisation of Securities Commissions, *Investment Management Risk Assessment: Marketing and Selling Practices*”

<http://www.iosco.org/library/pubdocs/pdf/IOSCPD156.pdf> (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 40.

<sup>21</sup> Selling could be defined as ‘a person offering or concluding a PEPP contract to a customer’. See for a similar definition under Art. 4(5) PRIIPR: ‘person selling a PRIIP’ means a person offering or concluding a PRIIP contract with a retail investor’.

<sup>22</sup> Recital 38 Art. 2(1) PRIIPR; Cf. ‘distributors’ under Recital 15 MiFID II are investment firms that offer or sell financial instruments and services to clients. Under the IDD, ‘distributors’ are those involved in insurance distribution activities, including tied agents, brokers, direct channels (including online sales), full and ancillary insurance intermediaries. See Recital 28 IDD.

<sup>23</sup> Cf. Art. 4(5) PRIIPR: ‘person selling a PRIIP’ means a person offering or concluding a PRIIP contract with a retail investor’.

IDD and MiFID II to PEPPs would imply that product oversight and governance requirements under these acts would apply to PEPPs.<sup>24</sup> Under this approach, both product manufacturers that manufacture and distribute PEPPs and distributors that merely distribute products that are manufactured by other providers would be targeted, according to their role.<sup>25</sup>

The PEPP initiative departs from the point of view that consumers regard financial products as too complex and that disclosure does not, on its own, allow consumers to make better investment decisions due to cognitive and behavioural biases.<sup>26</sup> Extending the IDD and MiFID II product governance requirements to PEPPs would require PEPP providers and distributors to take measures to monitor the correct target market for the product prior to a PEPP launch on the market and during the lifecycle of the PEPP.<sup>27</sup> Upon concluding the PEPP contract, consumers are limited by picking amongst a limited number of investment options that are manufactured by the PEPP provider and regulated by intermediary (PEPP provider, distributor), product and sales regulation. The retirement objective prevents consumers from exiting all PEPP investments prior to the due retirement date. This restriction is, however, mitigated by consumers' rights to switch to another provider and transfer their funds during the life of the PEPP.

This Report does not propose a “one-size fits all” solution. Indeed, full DC PEPPs based upon an underlying UCITS/AIF, will have a depositary. In some Eastern European countries, full DC mandatory pension funds exist (pillar 1b). These funds work as follows. A registrar will conclude a contract with a provider and depositary. The registration together with the account administrator is responsible for ‘booking’ the corresponding units in the pension accounts belonging to the individual investors. The cooperation of the depositary for this purpose is needed.

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<sup>24</sup> Joint Committee, Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight & Governance Processes, [https://eiopa.europa.eu/Publications/Administrative/JC\\_2013\\_77\\_POG\\_\\_Joint\\_Position\\_.pdf](https://eiopa.europa.eu/Publications/Administrative/JC_2013_77_POG__Joint_Position_.pdf) (accessed 14 January 2017).

<sup>25</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 48; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 48.

<sup>26</sup> W. Tapia & J. Yermo, *Implications of Behavioural Economics for Mandatory Individual Account Pension Systems*, <http://www.oecd.org/dataoecd/5/22/39368306.pdf> (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 46.

<sup>27</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 46.

This Report proposes not to regulate a mandatory solution for this under the PEPP initiative. AIFs/UCITS with or without an investment guarantee could operate as they currently do under UCITSD V and the AIFMD. For insurance products, such as life insurance contracts with an underlying UCITS/AIF, providers (insurance companies) can also use the solution as they currently do. However, a personalized electronic domain should be accessible for the investor to see what the current value of the contractual claim towards the insurance company as PEPP provider is.

## **Tax**

Various types of tax hurdles/obstacles have been identified to the cross-border provision of PEPPs, including tax discrimination, system diversity and the ‘pensionista problem’.<sup>28</sup> These three problems are not necessarily a hurdle/problem alone, but they are also strongly interconnected. The European Commission and various interest groups have expressed their concern that tax obstacles could prevent the creation of an effective single market for PEPPs.<sup>29</sup> Over the past decades, the CJEU has mostly eradicated tax discrimination in its case law.<sup>30</sup> Nevertheless, problems related to system diversity and the ‘pensionista problem’ continue to exist. In these areas, differences between the taxation systems of Member States related to the deductibility of contributions and the taxation of benefits could possibly pose a problem for PEPP holders.<sup>31</sup> Currently, some Member States do not or hardly facilitate third-pillar private pensions by means of taxation, whereas other Member States allow deductions with the maximum deduction of contributions that applies to contributions of all three pillars.<sup>32</sup> There are even Member States that only allow deductions of contributions if there is a ‘pension gap’.<sup>33</sup> The Member States that do provide tax incentives mostly apply the EET system.<sup>34</sup> Broad acceptance of the EET system and extending existing systems to PEPPs would encourage pension savings. Tax deferral has proven to be an effective incentive for taxpayers to save for retirement. To encourage PEPP investments, Member States could consider applying

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<sup>28</sup> Cf. B. Starink & H. Van Meerten, *Cross-border obstacles and solutions for pan-European pensions*, 1 EC Tax Review 30 (2011); H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 22, <https://ssrn.com/abstract=2425478> (accessed 28 October 2016).

<sup>29</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 37.

<sup>30</sup> P. Schonewille, *To what extent is tax still an issue for IORPS?*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ipe\\_sep2005.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ipe_sep2005.pdf) (accessed 13 January 2017); P. Schonewille, *The elimination of tax obstacles to pan-European pension funds: An overview*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/occ\\_pen\\_article3.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/occ_pen_article3.pdf) (accessed 13 January 2017).

<sup>31</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 18.

<sup>32</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 144 (2007).

<sup>33</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 144 (2007).

<sup>34</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

the principle of ‘compensating layers’, or substitute tax relief, by a matching contributions system. Extending the EET system to all Member States would eradicate most, but not all, problems. EET systems are complicated and may lead to double (non)taxation in migration cases. Politically, it is hardly feasible to harmonize the direct taxation field. For this reason, the sole realistic remedy seems to be a renegotiating of tax treaties between the Member States concerned. PEPP providers may deal with taxation issues by creating sub-accounts linked to main accounts. This solution is, however, limited to their PEPP product passport. If a PEPP provider does not offer PEPPs in the Member State where a PEPP holder is migrating to, the provider is forced to ‘lock-in’ the account. Even if tax obstacles are not remedied on the European level, the introduction of the PEPP would still lead to a single market for PEPPs as it facilitates the cross-border supply of PEPPs and enhances consumer choice and reduces costs.<sup>35</sup>

### **Comparative Research - Sweden, UK, US & the Netherlands**

A review of current PPP regimes in Sweden, the UK and the US have indicated that the regulatory and tax regime of PPP regimes, on the one hand, and second- and third-pillar PPP regimes are more closely aligned as so far has been assumed. In Sweden, for example, the successful third-pillar IPS regime had been introduced in the 90’s but its tax advantages were recently abolished. The abolishment was made upon the assumption that most Swedes are covered by the overhauled Swedish second-pillar personal pension accounts regime that is deemed to be providing sufficient retirement income. For this reason, Sweden only maintains tax advantages for Swedes investing in IPS third-pillar accounts that are not covered by its second-pillar regime.

In the UK and the US, the close alignment is more evident. The UK has different types of personal pensions including (Group) stakeholder pension schemes, (Group) SIPP and (Group) Personal Pension. For regulatory and tax purposes, the differences between the personal and occupational pensions in the UK are not clear-cut. Personal pension schemes may be invested in by employed, unemployed or self-employed people. In this regard, personal pensions that are ‘Group’ pensions are being provided by employers for their employees. Nevertheless, employers may agree with their employees to contribute to their stakeholder pension schemes or SIPPs. This nature is also reflected by the tax relief applying to contributions to all types of personal pension schemes.

Similarly, the employer-sponsored 401(k) and (third-pillar) IRA plans in the US are largely comparable and similarly regulated for tax purposes. An overview of the regulatory framework of PPPs in Sweden, the UK and the US, thus, indicates that the PEPP might inspire the European regulator and individual Member States to extend the PEPP to the second-pillar domain and that more Member States might introduce a ‘compensating layer’ for tax purposes

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<sup>35</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 38.

that takes into account pension savings made in both the second- and the third-pillar. Although being a second-pillar product, the Dutch PPI could also serve as an inspiration for the PEPP.

## 1 Introduction

'Very importantly, in my view, the Capital Markets Union can only succeed if we are capable of regaining confidence of the European Union citizens in the financial markets. In this sense I strongly believe that supervisory convergence needs to be a high level priority of the Capital Markets Union'<sup>36</sup>

In July 2012, the European Commission asked EIOPA, in the broader context of efforts to develop private funded pensions, to advise on a legal framework for a Single Market for personal pension products (PPPs).<sup>37</sup> Following a Discussion Paper<sup>38</sup>, a Preliminary Report<sup>39</sup> and a draft advice<sup>40</sup>, EIOPA published in April 2016 its Final Report on the Public Consultation of a standardized Pan-European Personal Pension Product (PEPP).<sup>41</sup> EIOPA's advisory work concentrated around the establishing of (1) a common regulatory framework for all existing PPPs currently under the national laws of the individual Member States (Directive)<sup>42</sup> and (2) the establishing of a 2<sup>nd</sup> regime (also known as the 29<sup>th</sup> regime) that would serve as an alternative uniform European system to different national regimes<sup>43</sup> allowing private parties (providers and PPP holders) to choose whether the European or a national regime governs their legal relationship.<sup>44</sup>

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<sup>36</sup> 'Exploring new horizons for the benefit of the citizens in the European Union', speech of EIOPA Chairman, Gabriel Bernardino, at the 6th Annual Conference of EIOPA in Frankfurt.

<sup>37</sup> European Insurance and Occupational Pensions Authority, *Letter to Mr. Jonathan Fall (DG Internal Market and Services) on the "EIOPA Preliminary Report— Towards an EU Single market for personal pensions"*, 19 February 2014; European Commission, *Technical advice to develop an EU Single Market for personal pension schemes*, 18 July 2012, Ref. Ares(2012)876976, [http://ec.europa.eu/internal\\_market/pensions/docs/calls/072012\\_call\\_en.pdf](http://ec.europa.eu/internal_market/pensions/docs/calls/072012_call_en.pdf) (accessed 14 January 2017).

<sup>38</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241.

<sup>39</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions — An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 4.

<sup>40</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457.

<sup>41</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341.

<sup>42</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions — An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 41.

<sup>43</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions — An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 46.

<sup>44</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions — An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 46.

The two-track PEPP/PPP European initiative, allowing for a European (product) passport for PEPPs, is in line with the advice in the 2011 White Paper on Pensions<sup>45</sup> to enhance the development of private retirement savings to realize efficiency gains through diversification, innovation and scales of economies on the side of the providers.<sup>46</sup> On the other hand, the product passport for individual pension products could help to overcome the ‘financing gap’<sup>47</sup> for SMEs.<sup>48</sup>

Developing complementary personal retirement savings was seen as a regulatory tool to develop third-pillar pension systems in EEA Member States where occupational pensions are not well developed.<sup>49</sup> The PEPP initiative on personal pensions is intended to play a greater role in securing pensions, reduce the burden on public pension schemes and increase pension income.<sup>50</sup> It serves as an answer to overcome the pressure being put by the low interest rates on funded schemes. Furthermore, the PEPP/PPP initiative intends to diminish the obstacles to labour mobility and adapt to the general shift from DB to DC schemes.<sup>51</sup> The PEPP/PPP European initiative, thus, plays a major role in overcoming the ‘pensions gap’<sup>52</sup>.

The initiative focusses on establishing a common regulatory framework for PEPPs/PPPs in harmonizing regulation applying to PEPP providers/distributors, depositaries/custodians, the position of consumers, the standardization of PEPP/PPP product regulation and sales regulation.

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<sup>45</sup> European Commission, White Paper -An Agenda for Adequate, Safe and Sustainable Pensions, 16 February 2012, COM(2012) 55 final{SWD(2012) 7 final}{SWD(2012) 8 final}.

<sup>46</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 4; See for the development of a similar product in Australia: Australian Government, *Development of the framework for Comprehensive Income Products for Retirement*, Discussion Paper, 15 December 2016, [https://consult.treasury.gov.au/retirement-income-policy-division/comprehensive-income-products-for-retirement/supporting\\_documents/CIPR%20Discussion%20Paper.pdf](https://consult.treasury.gov.au/retirement-income-policy-division/comprehensive-income-products-for-retirement/supporting_documents/CIPR%20Discussion%20Paper.pdf)

<sup>47</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 8,9, [https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf)

<sup>48</sup> See also Recital 1, 3, 6 ELTIFR; See also Recital 13, 17 EuSEFR/EuVECAR.

<sup>49</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 4.

<sup>50</sup> Cf. European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 7-9.

<sup>51</sup> Cf. D.L. Kruse, *Pension Substitution in the 1980s: Why the Shift Toward Defined Contribution Pension Plans?*, NBER Working Paper No. w3882 (1991), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=473998](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=473998) (accessed 14 January 2017).

<sup>52</sup> See the responses of APG, Better Finance response to Consultation Paper 16-001: European Insurance and Occupational Pensions Authority, *Summary of Comments on Consultation Paper 16-001*, 14 July 2016, EIOPA-BoS-16/467, 20, 44; European Commission, White Paper -An Agenda for Adequate, Safe and Sustainable Pensions, 16 February 2012, COM(2012) 55 final{SWD(2012) 7 final}{SWD(2012) 8 final}.



In the last couple of years, questions arose around how the PEPP should ideally be regulated and the European Commission and various interest groups, till now, have not found a solution for all possible problems in developing a common regulatory framework.

For that purpose, this Report focusses on how the PEPP could ideally be regulated at EU level. The Report discusses the PEPP and the PPPs initiative, how PEPPs as a ‘wrapper product’ should be defined and how a PEPP (product) passport under a future PEPP Regulation could be established. Furthermore, this Report focusses on the possible regulation for PEPP providers/distributors, depositaries/custodians, the position of consumers, the standardization of PEPP/PPP product regulation and sales regulation. It concludes by reviewing possible tax barriers related to the PEPP and migrating PEPP holders and the lessons that can be learned from the existing (personal) pension framework in Sweden, the UK, the US and the Netherlands.

## 2 PEPPs versus PPPs

Upon the request of the European Commission, EIOPA tried to establish a common definition of PEPPs (still being generally referred to as PPPs) in its Discussion Paper<sup>53</sup> and the ‘Report to the European Commission’.<sup>54</sup> EIOPA clearly had difficulties in establishing a profound legal definition of PEPPs.<sup>55</sup> The difficulty of defining PEPPs/PPPs arises from the large variety of definitions reflected by the regulatory and tax regimes currently applying to PPPs within the individual Member States.<sup>56</sup> The ‘personal private pension schemes’ definition of the OECD<sup>57</sup> was taken into account and, on the basis of this, EIOPA performed a mapping exercise of pension plans/products that would fulfill this definition. The EIOPA Database of Pension plans/products showed a large variety of pension products within the EEA that could be grouped into PPPs and/or providers being regulated and unregulated at the EEA level.<sup>58</sup>

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<sup>53</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 9.

<sup>54</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 11-17.

<sup>55</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 11-17.

<sup>56</sup> T. Nijman, N. Määtänen, A. Vörk, M. Piirits & R.I. Gal, *Analysis of the standardized Pan European Personal Pension (PEPP) product and its impact in four European countries: the Netherlands, Estonia, Finland and Hungary*, Netspar Academic Series DP11/2015-064 (2015), <http://arno.uvt.nl/show.cgi?fid=139754> (accessed 14 January 2017); H. Van Meerten, *Het ontstaan van een Europese Pensioen Unie* (11 November 2015), <https://ssrn.com/abstract=2689754> (accessed 14 January 2017); H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 22, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>57</sup> J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 3, 4, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>58</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, Annex I.

On the basis of the information available to EIOPA, the OCERP<sup>59</sup> and the EPP<sup>60</sup> initiative, EIOPA decided to examine separate definitions for an European initiative harmonizing existing PPPs and PEPPs under a second regime (29<sup>th</sup> regime). The first definition shall establish a directive providing enhanced consumer protection requirements covering the whole spectrum for existing PPPs together.<sup>61</sup> This broad definition is aimed to apply to a wide range of plans across Member States.<sup>62</sup> A more narrow definition is considered that would exclude many PPPs at the national level and defines a more specific set of features for PPPs to comply with to qualify for an EEA passport.<sup>63</sup> The second regime for PPPs qualifying as ‘PEPPs’ would be an optional highly standardized product.<sup>64</sup>

### 3 A Definition for Existing PPPs

In EIOPA’s PPP report a definition of the PRIIP Proposal<sup>65</sup> has been considered as a starting point:

‘products which under national law are recognized as having the primary purpose of providing the investor an income in retirement and which entitles the member to certain benefits.’<sup>66</sup>

The criticism put forward is that national regulatory and tax law in defining PPPs currently widely differ.<sup>67</sup> For that purpose, EIOPA proposed to further refine this definition by adding

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<sup>59</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013,

[https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf).

<sup>60</sup> European Fund and Asset Management Association, *The European Personal Pension Account*, May 2005, [https://www.efama.org/Publications/Public/Long-Term\\_Savings\\_and\\_Pension\\_Steering\\_Committee/eppareport.pdf](https://www.efama.org/Publications/Public/Long-Term_Savings_and_Pension_Steering_Committee/eppareport.pdf) (accessed 14 January 2017).

<sup>61</sup> See on consumer protection: Directorate General for Internal Policies, *Consumer Protection Aspects of Financial Services*, IP/A/IMCO/ST/2013, 07 February 2014,

[http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/507463/IPOL-IMCO\\_ET%282014%29507463\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/507463/IPOL-IMCO_ET%282014%29507463_EN.pdf) (accessed 14 January 2017);

Organisation for Economic Co-operation and Development, *G20 High Level Principles Financial Consumer Protection*, <http://www.oecd.org/dataoecd/58/26/48892010.pdf> (access 21 December 2016).

<sup>62</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 14.

<sup>63</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 14.

<sup>64</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 40.

<sup>65</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 15.

<sup>66</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 14.

that the term ‘investor’ must be replaced by a ‘more appropriate term’, PPPs must be ‘funded’, PPPs are based upon a contract between a provider and an individual allowing employers to make contributions.<sup>68</sup> Other elements/amendments include that the PPP must limit or exclude the option for early withdrawal and surrender.<sup>69</sup> EIOPA stressed that any PPP-initiative would need to exclude public pension plans (1<sup>st</sup> pillar) and occupational pension plans (2<sup>nd</sup> pillar) from the definition of PPP.<sup>70</sup>

For the purpose of this Report, PPPs will not be further considered. A harmonized PPP regime is considered by the industry and EIOPA as too difficult to accomplish given the significant divergence in national legislative frameworks in the European market of personal pensions.<sup>71</sup> The PPP also falls outside the scope of this Report.

### 3 The PEPP as ‘Wrapper Product’ – Establishing a Definition

The PEPP initiative should apply to all third-pillar retirement products that are ‘manufactured’ by the financial services industry (PEPP providers) to provide investment opportunities to consumers with an explicit retirement objective.<sup>72</sup> Those products should be known as ‘PEPPs’ for the purpose of the PEPP initiative and should include, third-pillar insurance and investment products or a combination thereof that fulfils common features and product regulation setting out standardized and flexible elements.<sup>73</sup> These include, amongst others, investment products under the PRIIPR such as investment funds and life insurance policies.<sup>74</sup> The third-pillar retirement products offered in the EEA, however, go beyond the scope of the PRIIPR as they also include insurance products, such as life personal pension plans having a (pure) life insurance nature that are not covered by the PRIIPR.<sup>75</sup> For the purpose of this initiative, a new

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<sup>67</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 14; See the responses of Allianz SE, the Association of British Insurers, and the Insurance Reinsurance Stakeholder Group (IRSG) to Consultation Paper 16-001: European Insurance and Occupational Pensions Authority, *Summary of Comments on Consultation Paper 16-001*, 14 July 2016, EIOPA-BoS-16/467, 2, 17, 40.

<sup>68</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 14.

<sup>69</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 14.

<sup>70</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 15.

<sup>71</sup> See the response of Arbeitsgemeinschaft für betriebliche Alstervorsorg to Consultation Paper 16-001: European Insurance and Occupational Pensions Authority, *Summary of Comments on Consultation Paper 16-001*, 14 July 2016, EIOPA-BoS-16/467, 28.

<sup>72</sup> See for the retirement objective: European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7

<sup>73</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 5.

<sup>74</sup> Recital 6 PRIIPR.

<sup>75</sup> See Art. 2(2)(e) PRIIPR excludes ‘pension products which, under national law, are recognised as having the primary purpose of providing the investor with an income in retirement and which entitle the investor to certain

definition of ‘PEPP’ would need to be designed that is (1) coherent with the current EEA legislative framework, (2) covers as many (EEA) third-pillar retirement products and providers as possible and (3) offers a level playing field that balances the interests of EEA consumers.

Important to note in establishing the scope and definition of the PEPP initiative is that EIOPA does not desire that consumers invest ‘directly’ by buying and holding assets themselves. Instead, PEPPs are third-pillar retirement products that intercede between consumers and the ‘markets’ through a process of packaging or wrapping together investment, insurance products or a combination thereof to create different exposures, provide different product features, or achieve different cost structures as compared with a direct holding. Such ‘packaging’ or ‘wrapping’ of investment and insurance products in a ‘PEPP’ allows consumers to (1) make easier investment decisions, (2) (indirectly) invest in products that would otherwise be inaccessible or impractical and (3) to make easy comparisons between different PEPPs.<sup>76</sup>

A potential PEPP definition could be used to determine the legislative scope of the PEPP initiative would, thus, need to cover (1) third-pillar retirement products that are ‘wrapped’ by sharing (2) general ‘PEPP’ features and (3) complying with PEPP product regulation that consists of ‘standard’ and ‘flexible elements’. In establishing a definition, the latter three elements will now be discussed.

### **3.1. Eligible Third-Pillar Retirement Products**

The PEPP initiative has so far not discussed what type of third-pillar retirement products would be eligible for PEPPs.

EIOPA, however, performed a mapping exercise on the basis of its Database of Pension Plans/Products that showed a variety of third-pillar retirement products within the EEA that could be eligible as PEPPs.<sup>77</sup> The EIOPA Database<sup>78</sup> showed on the EEA level PEPPs (PPPs) and providers being regulated by the Solvency II, CRD IV and UCITSD V (AIFMD).<sup>79</sup> EIOPA also identified various sub-types of current PPPs and/or providers that are currently unregulated at the EEA level but for which European law is taken into account as an informal reference.<sup>80</sup> The sub-types identified were PEPPs to which the IORPD(II) is voluntarily applied and that are

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benefits’. Similarly, Art. 2(2)(f) PRIIPR excludes IORPs, whereas Art. 2(2)(g) PRIIPR excludes personal occupational pension plans from the scope of the PRIIPR

<sup>76</sup> Cf. Recital 6 PRIIPR.

<sup>77</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, Annex I.

<sup>78</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, Annex I.

<sup>79</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, Annex 1-3.

<sup>80</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 9.

allowed to provide both occupational and personal pension plans<sup>81</sup> and voluntary pension funds that are (in part) subject to a UCITS-like national regime.<sup>82</sup> 1<sup>st</sup> pillar bis systems<sup>83</sup> and group pensions/contracts<sup>84</sup> as ‘borderline cases’ were also considered whether or not these should be included in a future PEPP initiative.

The PEPP initiative so far does not explicitly mention whether or not the underlying third-pillar product offered as a PEPP is required to be merely an EEA third-pillar retirement product or that non-EEA regulated products are also allowed. In establishing a definition of ‘eligible third-pillar retirement products’, both EEA and non-EEA retirement products may be classified in insurance and non-insurance products.<sup>85</sup>

### **3.1.1 Insurance Products**

A mapping exercise conducted in 2013 by the European Commission indicated two types of insurance products that could be considered as third-pillar retirement products that would be eligible as PEPP: personal pension plans which conditions are agreed upon between the insurer and the consumer and hybrid insurance or investment products with an accumulation approach for pension purposes. The latter includes investment-based insurance products (IBIPs) that are typically unit-linked products<sup>86</sup> and insured pensions<sup>87</sup>.

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<sup>81</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 9, 10; EIOPA, in this regard, notes that applying the different set of rules to personal and occupational pension products might in practice place an unnecessary burden upon the IORP provider.

<sup>82</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 10.

<sup>83</sup> See European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 20-23; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 88-94.

<sup>84</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 17.

<sup>85</sup> European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products*, 7, [http://ec.europa.eu/dgs/health\\_food-safety/dgs\\_consultations/ca/docs/swd\\_consumer\\_protection\\_thirds\\_pillar\\_pensions\\_en.pdf](http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf) (Accessed 14 January 2017).

<sup>86</sup> European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products*, 7, [http://ec.europa.eu/dgs/health\\_food-safety/dgs\\_consultations/ca/docs/swd\\_consumer\\_protection\\_thirds\\_pillar\\_pensions\\_en.pdf](http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf) (Accessed 14 January 2017).

<sup>87</sup> The OECD defines this category as pension plans offered by insurers and consisting exclusively of insurance products. See J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, Section 2.2., <http://www.oecd.org/pensions/private-pensions/2488707.pdf> (accessed 14 January 2017).



Insurance third-pillar retirement products, its providers and distributors are exclusively regulated on the European level.<sup>88</sup> Both products and providers are regulated by Solvency II, whereas distributors are regulated by the IDD.

### **3.1.2 Non-Insurance Products**

Non-insurance third-pillar retirement products are offered both as EEA and non-EEA products. EEA products offered primarily include UCITS and retail AIFs<sup>89</sup> directly offered under the UCITSD V and AIFMD or ‘wrapped’ in another product such as a (hybrid) personal pension plan. In addition, IORPs may be allowed on the Member State level to provide not only occupational but also personal pension plans.<sup>90</sup> Finally, credit institutions may under CRD IV offer savings products used for retirement income purposes.<sup>91</sup>

The products and providers of these non-insurance are regulated on the EEA level. Nevertheless, all of these providers may ‘package’ the EEA investment product in another product layer.<sup>92</sup> Apart from the sales/distribution regulations that EEA sectoral legislation (including, for example, the AIFMD and UCITSD V) contain, UCITS and AIFs may also be distributed by investment firms under MiFID II. In addition, the PRIIPR applies to AIFs and UCITS will be likely included in the future.<sup>93</sup>

On the national level, non-occupational pension funds (voluntary Pension Funds) and (hybrid) personal pension plans based on various types of commercial investment products, such as UCITS and retail-AIFs are being offered.

#### **3.1.2.1 Voluntary Pension Funds**

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<sup>88</sup> See the response of the Association of British Insurers, to Consultation Paper 16-001: European Insurance and Occupational Pensions Authority, *Summary of Comments on Consultation Paper 16-001*, 14 July 2016, EIOPA-BoS-16/467, 39.

<sup>89</sup> Art. 43 AIFMD.

<sup>90</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 9, 10; EIOPA, in this regard, notes that applying the different set of rules to personal and occupational pension products might in practice place an unnecessary burden upon the IORP provider.

<sup>91</sup> ‘Banksparen’, for example, in the Netherlands are deposits that may be linked to the purchase of annuities on retiring. See European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products*, 7, [http://ec.europa.eu/dgs/health\\_food-safety/dgs\\_consultations/ca/docs/swd\\_consumer\\_protection\\_thirds\\_pillar\\_pensions\\_en.pdf](http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf) (Accessed 14 January 2017).

<sup>92</sup> European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products*, 9, [http://ec.europa.eu/dgs/health\\_food-safety/dgs\\_consultations/ca/docs/swd\\_consumer\\_protection\\_thirds\\_pillar\\_pensions\\_en.pdf](http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf) (Accessed 14 January 2017).

<sup>93</sup> PRIIPR is modelled after the KIID Regulation that was first established for UCITS. After a transitional period of time, it is expected that UCITS will be included in the PRIIPR to ensure consistency with AIFs and other PRIPs under the PRIIPR. See for the definition of PRIP as part of the PRIIP definition: Art. 4(1) PRIIPR.

Various Member States offer, 3rd pillar national voluntary pension funds that are based upon UCITS and contain similar prudential elements to the management company (PEPP provider), the depositary and similar investor protection measures to the pension funds (e.g. pre-contractual information, ongoing information, selling practices, caps on fees charged by management companies). These prudential regimes are, however, primarily based upon the national implementation of the UCITSD I-IV provisions that only contained minimum harmonization leading to huge differences related to various regulatory requirements related to, for example, the depositary regimes of these type of voluntary pension funds.<sup>94</sup> The relevant question is whether these voluntary pension fund regimes offer the same level of investor protection as the current AIFMD, UCITSD V and IORPD II standards. To ensure consistency and an equivalent level of consumer protection on the EEA, it would be necessary to require a huge body of EEA legislation to be applicable to the providers and the voluntary pension fund as product itself. This would be hugely cumbersome and it is, therefore, recommended to only allow EEA providers of AIFs, UCITS and IORPs to offer PEPPs.

### 3.1.2.2 (Hybrid) Personal Pension Plans

Member States currently offer a large variety of (hybrid) personal pension plans in the EEA. It is questionable whether many of these national products adhere to the product as proposed under the PEPP initiative. Many of the current national products regulating (hybrid) personal pension plans, for example, allow not only ‘pooled funds’, i.e. fully standardized investment options that leave only standard portfolios and a couple of options over for the consumer to decide upon. Instead, they allow both ‘pooled funds’ and ‘non-standardized products’.<sup>95</sup>

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<sup>94</sup> See for the depositary regimes of these ‘AIFMD pension funds’ for which no European legislation is applicable: Czech Republic: § 88-92 427/2011 Coll. LAW on supplementary pension savings, November 6, 2011; § 38 -41 426/2011 Coll. on retirement savings Law November 6, 2011; Hungary: § 76 Act LXXXII of 1997 on Private Pensions and Private Pension Funds (Voluntary pension fund); Estonia: § 92-96 Estonian Investment Funds Act (voluntary pension fund); Spain : Article 21 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulación de los Planes y Fondos de Pensiones (personal pension fund); Poland: Chapter 16 Depositary , Act of 28 August 1997 Law on Organisation and Operation of Pension Funds (open pension fund); Portugal : Decreto-Lei n.º 12/2006 de 20 de Janeiro, CAPÍTULO II Depositários (individual membership of open pension funds; See also: Discussion Paper on a possible EU-single market for personal pension products, Annex 1 - Examples of (pure) Personal Pension Plans/Products in EU Member States, 37 et seq.

<sup>95</sup> ‘Pooled funds’ and ‘non-standardized products’ are terminology used under the Irish PRSA regime. However, similarities in application of this terminology can be found in other Member States. See for the Irish PRSA: Pensions (Amendment) Act, 2002; The Pensions Authority, Personal Retirement Savings Accounts (PRSAs) – A consumer and employer’s guide to PRSAs, [http://www.pensionsauthority.ie/en/Publications/Information\\_Booklets/PRSAs\\_-\\_a\\_consumer\\_and\\_employers%27\\_guide.pdf](http://www.pensionsauthority.ie/en/Publications/Information_Booklets/PRSAs_-_a_consumer_and_employers%27_guide.pdf) (accessed 14 January 2017); Sweden: The Individual Pension Savings Act(1993: 931); UK: There are two types of personal pension scheme: insured personal pensions, where each contract will have a set range of investment funds for planholders to choose from (this is not as restrictive as it sounds, as some modern schemes have over a thousand fund options) and self-invested personal pensions (SIPPs). See for insured personal pensions: S.43(1) Pensions Schemes Act; See for SIPPs: Finance Act 2004

In Ireland, for example, standard PRSA are restricted to ‘pooled funds’, i.e. life insurance contracts and collective investment schemes. The PRSA provider books the funds prior to investment in a separate account of a custodian appointed by him, so that the individual investor remains entitled to the contributions in the form of funds provided. For both, no personal custodian account is required for assets that PRSA providers have invested for the individual investor. Non-standard PRSA allows investment in funds other than ‘pooled funds’. Consumers investing in these PRSAs may pick individual (authorized) investment products in their portfolios. Other Member States, including Sweden and the UK have similar approaches.<sup>96</sup>

Taken from the current final advice, PEPPs offers a limited amount of fully standardized investment options that leave only standard portfolios and a couple of options over for the consumer to decide upon. Harmonizing the regulatory standards applying to these national products and providers under the PEPP initiative would, from a cost/benefit perspective, likely be too burdensome.

### **3.1.3 The ‘borderline cases’**

EIOPA in mapping existing pensions arrangements considered whether group pensions/contracts and 1<sup>st</sup> pillar bis arrangements should be eligible as retirement products under the PEPP initiative. EIOPA considered that these pension arrangements fulfil the common PEPP features<sup>97</sup> but should not fall within the scope of the PEPP initiative as these are not third-pillar retirement products. In other words, there are some ‘borderline cases’.

#### **3.1.3.1 Group pensions/contracts**

Group pensions/contracts, such as the Group Personal Pensions in the UK<sup>98</sup>, Fondi pensione aperti (open pension funds) in Italy<sup>99</sup> and Group life insurance in Germany<sup>100</sup> are being marketed as occupational and personal at the same time.<sup>101</sup> The main common characteristic is that the employer plays an important role in selecting and introducing group personal pensions/contracts.<sup>102</sup> For this reason, EIOPA concluded that group pensions/contracts would need to remain a matter of the competence of individual Member States as to whether these

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<sup>96</sup> *Ibid.*

<sup>97</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 25, 27.

<sup>98</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 18.

<sup>99</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 19.

<sup>100</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 19, 20.

<sup>101</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 17.

<sup>102</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 25.



schemes fall within their national implementation IORPD (II).<sup>103</sup> Group pensions/contracts not being subject to EEA legislation and sharing important characteristics of PEPPs/PPPs should be considered to be included, for at least some aspects, in the scope of any European initiative on PPPs (not PEPPs).<sup>104</sup>

### 3.1.3.2 1st Pillar bis

In the past two decades several Central and Eastern European (CEE) Member States have established the so-called 1<sup>st</sup> pillar bis schemes as part of their pension reforms.<sup>105</sup> 1<sup>st</sup> pillar bis schemes are schemes that (partly) substitute public PAYG systems as part of the contributions of the traditional PAYG system are diverted to 1<sup>st</sup> pillar bis pension funds managed by private pension providers.<sup>106</sup>

EIOPA considered that 1<sup>st</sup> pillar bis schemes meet many elements of the PEPP definition. They, however, are part of social security systems of Member States. The latter was considered by EIOPA not to be a profound basis for the PEPP/PPP initiative.<sup>107</sup>

Although Group pensions/contracts are proposed to be left outside of the scope of eligible retirement products under the PEPP initiative, the PEPP initiative will likely not prevent Member States from extending EEA PEPP regulations to their national products, providers and distributors on an unilateral basis.<sup>108</sup>

### 3.1.4 Eligible Third-Pillar Retirement Products – *Lex Ferenda*

#### 3.1.4.1 PEPP in the light of European Product Passports

The PEPP initiative so far does not explicitly mention whether or not the underlying third-pillar product offered as a PEPP is required to be merely an EEA third-pillar retirement product or that non-EEA regulated products are also allowed. Based upon the general principles underlying European product passports, such as UCITS and IORPs, both PEPP providers and the PEPP product would need to underlie harmonized legislation and supervision to benefit from a European passport.<sup>109</sup>

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<sup>103</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 25, 27.

<sup>104</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 25, 27.

<sup>105</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 90.

<sup>106</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 90.

<sup>107</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 25, 27.

<sup>108</sup> See paragraph 3.4: The PEPP as Member State Option - Towards a 'European Pensions Union'

<sup>109</sup> K. Lannoo, *The Great Financial Plumbing: From Northern Rock to Banking Union* (Rowman and Littlefield International 2015), 40.

EIOPA recently indicated that PEPP providers have to be an intermediary regulated under one of the European legal acts. This does, however, not prevent them from manufacturing and distributing products containing PEPP product features regulated by national law under the PEPP product passport. National laws, for instance, might allow AIFMs and UCITS Management Companies (UCITS ManCos) to not only act as a PEPP provider but also to manufacture and offer investment options in a voluntary pension fund or a (hybrid) personal pension plan which are regulated under national law. Similarly, any PEPP provider might distribute PEPPs that offer investment options in a voluntary pension fund and (hybrid) personal pension plans which do not necessarily adhere to the most recent EEA product standards, such as the depositary regulation introduced under UCITSD V.

Only allowing EEA regulated third-pillar pension products would ensure that PEPP providers cannot enter in regulatory arbitrage by choosing less well regulated underlying national products. In addition, not limiting eligible products to EEA products would mean that PEPP providers are able to use a marketing passport for PEPPs that compete with EEA third-pillar products. The European legislator, however, could be of the opinion that the general features and mandatory and flexible elements under PEPP product regulation provide enough consumer protection as to allow every single type of underlying third-pillar product to be ‘wrapped’ into the PEPP product passport. Nevertheless, it would be recommendable to restrict eligible third-pillar retirement products to EEA products and providers exclusively.

#### **3.1.4.2 Eligible Third-Pillar Retirement Products – A Proposal**

To ensure consistency, a PEPP definition would need to be based upon common features, PEPP product regulation and EEA eligible third-pillar retirement products. Eligible third-pillar retirement products could contain ‘insurance products’ and ‘non-insurance products’.

Insurance products could be defined as products (and providers) that are within the scope of Solvency II and may be distributed on the basis of the IDD. This would ensure consistency between insurance products, providers and the distribution of insurance products between the PEPP initiative and the general EEA insurance legislative framework.

Non-insurance PEPPs could be limited to UCITS, retail AIFs<sup>110</sup>, IORPs<sup>111</sup> and saving products under CRD IV. UCITS and retail AIFs fall within the scope of the PRIIPR and may be distributed by investment firms under MiFID II.

Due to their occupational mandatory nature, IORPs do not fall within the scope of the current EU law distribution landscape. Moreover, IORPs have a diverging nature throughout the

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<sup>110</sup> Art. 43 AIFMD.

<sup>111</sup> Apart from the EEA provisions related to the ‘occupational nature’, IORPs may be construed in a similar way as national voluntary pension funds. Nevertheless, IORPs are a fully harmonized European product that had been embedded under IORPD II the latest EEA regulatory developments.

IORPD (II) Member State implementations. Some Member States, such as the Netherlands (PPI, see below) and Luxembourg (SEPCAV have investment fund alike IORPs, whereas other Member States offer DB pension funds and insurance company type of IORPs (France for instance). IORPs, such as the Dutch PPI and Luxembourg SEPCAV, are suitable for the PEPP. Therefore, a clear desire in Europe exists to include them in the PEPP initiative. Any hybrid and DB schemes seems to attract no investor interest as these funds are not attractive due to the deficits in DB funds. Considering this, only ‘investment fund alike’ IORPs are attractive and suitable and, therefore, it seems logical to include them in the ‘funds MiFID II distribution domain’. The PEPP initiative could regulate this by stating that IORP units/shares distributed to consumers by IORPs for the purpose of the PEPP initiative are considered to be ‘financial instruments’ under MiFID II. The MiFID II distribution regime would then also be applicable to IORPs. For savings products offered by credit institutions under CRD IV, a different solution would need to be found.

### **3.2 Common Features**

PEPP is a European brand of personal pension product to be distributed on a cross-border basis. Eligible third-pillar pension products are required to possess a number of ‘common features’, i.e. a ‘wrapper’ to qualify as a PEPP.<sup>112</sup> These common features reflect the ‘personal pension product’ nature of the PEPP and include, *inter alia*, individual membership, individual accounts, an explicit retirement objective, funded plans, a limitation of withdrawals and authorized PEPP providers.<sup>113</sup>

#### **3.2.1 Individual Membership**

A PEPP must be based upon a contract or agreement between an individual and a financial institution.<sup>114</sup>

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<sup>112</sup> EIOPA so far has not considered a specific definition what PPPs would qualify as ‘PEPP’. See the response of Arbeitsgemeinschaft für betriebliche Altersvorsorge to Consultation Paper 16-001: European Insurance and Occupational Pensions Authority, *Summary of Comments on Consultation Paper 16-001*, 14 July 2016, EIOPA-BoS-16/467, 28.

<sup>113</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7; European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 15.

<sup>114</sup> Employers, therefore, do not play a role in establishing a PEPP, but may pay contributions to a PEPP of any individual; See European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7; European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 15; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 10; Employers do not play a role in establishing or sponsoring a PPP but may pay contributions to an individual PPP on behalf, or for the benefit, of the employee. Individuals can independently purchase and select material aspects of the arrangements. Self-employed persons are often seen as potential PPP members; European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 12-15.

The ‘contract or agreement’ concluded indicates that the PEPP under the OECD taxonomy for pension plans may be classified as a ‘pension plan’.<sup>115</sup> Pension plans are pension (retirement income) plans (arrangements or schemes) based upon a (legally binding) contract that has an explicit retirement objective.<sup>116</sup>

The contract or agreement is concluded between an individual and a ‘financial institution’. The latter implies that PEPP is a ‘private pension plan’, i.e. a plan where an institution other than the general government<sup>117</sup> administers the payment of pension benefits.<sup>118</sup> The financial institution as private sector provider indicates that the PEPP is a (voluntary) personal pension plan.<sup>119</sup> Unlike IORPs, PEPPs are not linked to an employment relationship.<sup>120</sup> Individuals may independently decide to invest in a PEPP without intervention of their employers.<sup>121</sup> Investment in these plans is, thus, voluntary for individuals (individual Membership).<sup>122</sup>

### **3.2.2 Individual Account**

PEPPs are financed by contributions paid to an individual account either made by product holders/owners or third parties on their behalf.<sup>123</sup> The payment to an individual account implies that an account only comprises the assets of a single individual.<sup>124</sup> Each individual has his/her own individual account in which contributions are recorded and that shows the amount accrued since he/she joined the PEPP.<sup>125</sup> Although PEPPs are not linked to an employment relationship,

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<sup>115</sup> J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 2, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>116</sup> J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 2, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>117</sup> This are the central, state, local governments and include social security institutions; J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 3, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>118</sup> J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 3, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>119</sup> Social Protection Committee, *Privately Managed Funded Pension Provision and their Contribution to Adequate and sustainable Pensions* (2008), 9, <http://ec.europa.eu/social/BlobServlet?docId=743&langId=en> (accessed 14 January 2017).

<sup>120</sup> J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 4, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>121</sup> J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 3, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>122</sup> J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 4, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>123</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7.

<sup>124</sup> Social Protection Committee, *Privately Managed Funded Pension Provision and their Contribution to Adequate and sustainable Pensions* (2008), 6, <http://ec.europa.eu/social/BlobServlet?docId=743&langId=en> (accessed 14 January 2017).

<sup>125</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 49.

‘third parties’, including employers, may pay contributions to a PEPP on their behalf or for the benefit of the employee, self-employed person or other individual.<sup>126</sup>

### **3.2.3 Explicit Retirement Objective**

PEPPs are primarily designed to provide an explicit source of retirement income, on top of statutory and occupational pensions and other sources of income.<sup>127</sup> In addition to having an explicit retirement objective, PEPPs may also cover biometric risks.<sup>128</sup>

The PEPP is based upon insurance and non-insurance products that are already regulated on the sectoral level and distributed to consumers for retirement purposes. The main difficulty in determining whether a PEPP has an explicit retirement objective is to distinguish a PEPP from products such as UCITS and (unit-linked) life insurances that are already used as investment for retirement purposes.<sup>129</sup> The additional ‘common features’ and product regulation applying to these third-pillar retirement products under PEPP, however, ensure that consumers are obliged to invest money with an explicit retirement objective as individuals are only allowed to transfer their account balance from one PEPP provider to another but do not have the ability to transfer the money outside of the ‘PEPP system’.<sup>130</sup> Insurance and non-insurance products such as UCITS and (unit-linked) life insurances do not impose such a limitation on the enjoyment of the accrued interest for consumers.<sup>131</sup> Consumers are free under these sectoral legislative frameworks to withdraw accrued assets for any purpose, including consumption. The explicit retirement objective, thus, represents the ‘core feature’ of PEPPs in distinguishing this European product from other insurance and non-insurance products.

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<sup>126</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7; J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 3,4, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>127</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7; European Fund and Asset Management Association, *Towards a Single Market for European Personal Pensions: Building Blocks for an EU legislation*, March 2015, 7,

[https://www.efama.org/Publications/Public/EFAMA%20\\_EPP\\_Report\\_FINAL4March2015%29.pdf](https://www.efama.org/Publications/Public/EFAMA%20_EPP_Report_FINAL4March2015%29.pdf) (accessed 14 January 2017); EIOPA notes that given interlinks with national tax law requirements, this concept will need to be defined to a further extent in future work. See

European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7; European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 15.

<sup>128</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 13.

<sup>129</sup> Social Protection Committee, *Privately Managed Funded Pension Provision and their Contribution to Adequate and sustainable Pensions* (2008), 9, <http://ec.europa.eu/social/BlobServlet?docId=743&langId=en> (accessed 14 January 2017).

<sup>130</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 49.

<sup>131</sup> See, for example, the UCITS redemption policy: Art. 84 UCITSD V.



### **3.2.4 Funded**

PEPPs must be funded, i.e. financed by contributions paid by the individual itself or any other third party on behalf of the individual.<sup>132</sup> These pension plans have accumulated dedicated assets that may be identified reserves in the PEPP provider's balance sheet and/or segregated assets to pay for pension benefits.<sup>133</sup> The pay-as-you-go plans, also known as 'unfunded plans', that operate on a current disbursement method that is financed directly from the contributions of consumers are excluded from the scope of the PEPP initiative.

### **3.2.5 Limitation of Withdrawals**

As indicated above, the early withdrawal of accumulated capital under PEPP is limited. An individual may switch providers but may not withdraw the money outside of the 'PEPP system'.<sup>134</sup> The advantage of the 'closed PEPP system' is that consumers may bring their accounts with them when changing status, employer or country of residence.<sup>135</sup> The limitation of withdrawals ensures that the accumulated capital is only being paid out upon retirement or the occurrence of a biometric risk on the side of the consumer.<sup>136</sup>

### **3.2.6 Authorized PEPP Providers**

PEPP providers need to be regulated by (an existing) EEA body of prudential law and meet the EEA PEPP (product) requirements to be able to market/sell PEPPs on a cross-border basis.<sup>137</sup> Non-authorized PEPP providers that market or sell products that do not comply with the requirements under the PEPP initiative are explicitly prohibited from using the PEPP product passport.

### **3.2.7 Tax**

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<sup>132</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7.

<sup>133</sup> J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, 4,5, (accessed 14 January 2017) <http://www.oecd.org/pensions/private-pensions/2488707.pdf>.

<sup>134</sup> P. Vaze & R. Roker, *Is it Advisable? An Investigation into Switching and Advice in the Individuals Personal Pensions Market*, [http://www.consumerfocus.org.uk/files/2011/07/is\\_it\\_advisable.pdf](http://www.consumerfocus.org.uk/files/2011/07/is_it_advisable.pdf) (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 49.

<sup>135</sup> European Fund and Asset Management Association, *Towards a Single Market for European Personal Pensions: Building Blocks for an EU legislation*, March 2015, 7, [https://www.efama.org/Publications/Public/EFAMA%20\\_EPP\\_Report\\_FINAL4March2015%29.pdf](https://www.efama.org/Publications/Public/EFAMA%20_EPP_Report_FINAL4March2015%29.pdf) (accessed 14 January 2017).

<sup>136</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 13.

<sup>137</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7.

Although not explicitly mentioned as a ‘common feature’ by EIOPA, third-pillar retirement products that qualify as a PEPP may under the tax laws of individual Member States satisfy pre-requisites for special tax treatment, as is the case for many other insurance and non-insurance products that are designed to provide consumers with an income after retirement.<sup>138</sup>

### **3.3 Product Regulation**

The PEPP is intended as a standardized product consisting of eligible third-pillar retirement products that is based upon an authorization regime that is required to comply with product regulation that is to be achieved by the standardization of products.<sup>139</sup> The standardization of PEPPs might help to create a level playing field between different products and overcome barriers arising from the industry offering PEPPs and differences in national regulation in this area in developing an internal market in third-pillar retirement products.<sup>140</sup>

The proposed product regulation in the PEPP initiative is based upon two types of proposed elements: standardized and flexible elements. PEPPs fulfilling these requirements may make use of an notification procedure modelled after UCITS V and the AIFMD that enables the PEPP provider to market the product on the basis of a European marketing passport on a cross-border basis.

#### **3.3.1 Standardized or ‘Mandatory’ Features**

The standardized or ‘mandatory’ features related to the product are the default ‘core’ investment option and limited investment choice.<sup>141</sup>

##### **3.3.1.1 Default ‘Core’ Investment Option**

PEPP providers would be required to offer a ‘core’ investment option if they offer more than one investment option in which the PEPP holder is not required to make any further investment decisions to simplify decision-making over the PEPP choice and information requirements<sup>142</sup>

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<sup>138</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 28-33.

<sup>139</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47.

<sup>140</sup> See also Recital 3 PRIIPR; European Insurance and Occupational Pensions Authority, *Letter to Mr. Jonathan Fall (DG Internal Market and Services) on the “EIOPA Preliminary Report— Towards an EU Single market for personal pensions”*, 19 February 2014.

<sup>141</sup> Cf. International Organisation of Pension Supervisors, *Transparency and competition in the choice of pension products: The Chilean and UK experience* Working Paper No. 7 (2008), <http://www.iopsweb.org/dataoecd/6/61/41269756.pdf> 43 (accessed 14 January 2017); Cf. International Organisation of Pension Supervisors, *Information to Members of DC Pension Plans: Conceptual Framework and International Trends*, IOPS Working Paper No. 5 (2008), <http://www.iopsweb.org/dataoecd/7/16/41269701.pdf> (accessed 14 January 2017).

<sup>142</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001,

and that PEPP providers deem to be best suited for its PEPP holders. This option should contain a de-risking strategy for PEPPs that do not contain a guarantee.<sup>143</sup> The mechanism of pooling assets in investment vehicles and/or smoothing<sup>144</sup> would be suitable for the PEPP default investment option.<sup>145</sup> The de-risking strategy implies PEPP providers are allowed to lock-in realized investments, where appropriate, for PEPP holders that approach the retirement age, or another point in time during the accumulation period.<sup>146</sup> This strategy seeks to

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51-52; Z. Bodie & J. Treussard, *Making Investment Choices as Simple as Possible, but Not Simpler*, 63:3 Financial Analysts Journal 42-47 (2007); Cf. P. Antolin, S. Blome, D. Karim, S. Payet, G. Scheuenstuhl, J. Yermo, *Investment Regulations and Defined Contribution Pensions*, OECD Working Papers on Insurance and Private Pensions, No. 37 (2009), <http://www.oecd.org/dataoecd/38/15/43347646.pdf> (accessed 14 January 2017).

<sup>143</sup> A.K. Basu, A. Byrne & M.E. Drew, *Dynamic Lifecycle Strategies for Target Date Retirement Funds*, [http://www.griffith.edu.au/\\_data/assets/pdf\\_file/0007/132694/2009-02-dynamic-lifecycle-strategies-for-target-date-retirement-funds.pdf](http://www.griffith.edu.au/_data/assets/pdf_file/0007/132694/2009-02-dynamic-lifecycle-strategies-for-target-date-retirement-funds.pdf) (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 51; A. Kramer, B., R. Janssen & G. Boender, *Life cycle investing: from target date to goal based investing*, OFRC Applied Paper (2013); F.J. Gomes, L.J. Kotlikoff & L. Viceira, *Optimal Life-cycle Investing with Flexible Labor Supply: A Welfare Analysis of Life-cycle Funds*, 98 American Economic Review: Papers & Proceedings 297-303 (2008); W.D. Pfau, *Life-cycle Funds and Wealth Accumulation for Retirement: Evidence for a More Conservative Asset Allocation as Retirement Approaches*, 19 Financial Services Review 1 (2010); L.M. Viceira, L. M., 2007. *Life-cycle Funds*. Harvard Business School, NBER and CEPR (May 22, 2007); A. Kramer, B., R. Janssen & G. Boender, *Life cycle investing: from target date to goal based investing*, OFRC Applied Paper (2013).

<sup>144</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 18; European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 51-52.

<sup>145</sup> J. Choi, D. Laibson & B. Madrian, *The Importance of Defaults for Retirement Savings Decisions*, <http://www.nber.org/papers/w12009.pdf> (accessed 14 January 2017); P. Antolín, S. Payet & J. Yermo, *Assessing Default Investment Strategies in Defined Contribution Pension Plans*, <http://www.oecd.org/dataoecd/22/63/45390367.pdf> (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 6; Department of Work and Pensions, *Guidance for offering a default option for defined contribution automatic enrolment pension schemes*, <http://www.dwp.gov.uk/docs/def-opt-guid.pdf> (accessed 14 January 2017); Department of Work and Pensions, *Default Options in Workplace Personal Pensions*, DWP Research Report No. 628, <http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep628.pdf> (accessed 14 January 2017).

<sup>146</sup> P. Booth & Y. Yakoubov, *Investment policy for defined-contribution pensionscheme members close to retirement: An analysis of the "lifestyle" concept*, 4(2) North American Actuarial Journal 1-19 (2000); European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 18; J. Hibbert & P. Mowbray, *Understanding Investment Policy Choices for Individual Pension Plans*, 8 Pensions International Journal 41-62 (2002); P. Booth & Y. Yakoubov, *Investment policy for defined-contribution pensionscheme members close to retirement: An analysis of the "lifestyle" concept*, 4(2) North American Actuarial Journal 1-19 (2000); J. Hibbert & P. Mowbray, *Understanding investment policy choices for individual pension plans*, 8(1) Pensions 41-62 (2002).



maximize returns upon a defined risk level under the condition that potential issues of loss and regret aversion are mitigated.<sup>147</sup>

### 3.3.1.2 Limited Investment Choices

The PEPP provider should provide the customer with a limited number of investment options to help consumers in their choice.<sup>148</sup> EIOPA suggests that PEPPs should in any case consist of ‘investment vehicles’ that are suitable for the public.<sup>149</sup> Providers may also offer a limited range of alternative investment options in which a ‘range of funds’ are offered from several investment strategies that are suitable for consumers.<sup>150</sup> These alternative options are not required to contain a de-risking strategy or a guarantee.<sup>151</sup> Providers have a stronger duty of care concerning the suitability of alternative investment options.<sup>152</sup> Additional protections for the alternative investment options are incorporated in the information requirements and the sales regulations applying to these types of PEPPs.<sup>153</sup> All investment choices contain product types in which PEPP holders are not allowed to make individual selections of assets.<sup>154</sup>

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<sup>147</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 51-52

<sup>148</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 18; European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 51.

<sup>149</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 7.

<sup>150</sup> European Insurance and Occupational Pensions Authority, *Report on Investment options for occupational DC scheme members*, 28 01 2015, EIOPA-BoS-15/016; European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 7; European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 19-20.

<sup>151</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 6; Cf. Department of Labor, *Default Investment Alternatives under Participant Directed Individual Account Plans; Final Rule*, <http://www.dol.gov/ebsa/regs/fedreg/final/07-5147.pdf> (accessed 14 January 2017).

<sup>152</sup> Joint Forum, *Customer Suitability in the Retail Sale of Financial Services*, <http://www.bis.org/publ/joint20.pdf> (access 14 January 2017);

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

<sup>153</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 18.

<sup>154</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 18.

Given the standardized mandatory features of PEPPs, AIFs, UCITS, IORPs and unit-linked insurances based upon the latter three types of ‘investment vehicles’ are the most suitable types of third-pillar retirement products that would be eligible for PEPPs.

### **3.3.2 Flexible or ‘Optional’ Features**

PEPPs under the PEPP initiative are allowed to incorporate flexible features to allow providers to adapt their PEPPs to the EEA personal pension landscape.<sup>155</sup> Flexible elements include guarantees, a cap of cost and charges and the switching between providers.

#### **3.3.2.1 Guarantees**

PEPPs may choose to satisfy demand to provide for a minimum return guarantee.<sup>156</sup> The sectoral PEPP provider approach, however, limits the provision of a minimum return guarantee to those providers that are subjected to solvency requirements under Solvency II.<sup>157</sup> PEPP providers not being authorized to offer guarantees or biometrical risk covers for their PEPP may enter into a partnership with those providers that are being authorized to do so.<sup>158</sup>

PEPPs offering investment guarantee come at a cost and this will be reflected in disclosure offered to consumers, such as the KID document that sets out in simple terms the costs of PEPPs.

#### **3.3.2.2 Cap of Cost and Charges**

EIOPA does not require a mandatory cap on costs and charges as this could prevent healthy competition.<sup>159</sup> EIOPA considers investors to be sufficiently protected by disclosure and information requirements instead of a cap on costs and charges. Considering the cognitive biases and shortcomings in standardization of PEPPs, a cap on costs and charges might be useful for the default investment option to overcome consumer cognitive biases and shortcomings in standardization of PEPPs. EIOPA decided not to set a cap on costs at the

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<sup>155</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 58.

<sup>156</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 58.

<sup>157</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 6.

<sup>158</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 9.

<sup>159</sup> Cf. International Organisation of Pension Supervisors, *Comparison of Costs and Fees in Countries with Private Defined Contribution Pension Systems*, Working Paper No.6 (May 2008).

European level, however, allows individual Member States to set a cap.<sup>160</sup> Switching does not need to be cost-free, but costs need to be fair.<sup>161</sup>

### 3.3.2.3 Switching between Providers

PEPPs are long-term products. Sales and marketing regulation allows consumers to assess and amend their PEPP to ensure that their product still meets their needs.<sup>162</sup> To that extent, switching providers and the transfer of funds should allow consumers flexibility. The long-term nature implies that consumers could be locked into a provider until reaching the retirement age that could be detrimental to the interest of the provider.<sup>163</sup> The PEPP initiative does not require periodical cost-free switching. To overcome liquidity management issues for PEPP providers, some limitations on switching, including minimum holding periods should be allowed.<sup>164</sup>

## 3.4 The PEPP as Member State Option - Towards a ‘European Pensions Union’

A European instrument to harmonize PPP as ‘29th’ or ‘second’ Regime, i.e. a completely optional European harmonized regime for individual Member States to establish pension products, in addition to, the fully harmonized PEPP initiative, seems to be unrealistic. In order to harmonize PPP providers and the PPP providers on the national level, a European legal instrument would need to categorize several types of PPP providers and apply a huge range on European legislation to them, including the requirements laid down in CRD IV, IORPD II, UCITSD V, AIFMD and Solvency II.

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<sup>160</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 9; European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 54, 55.

<sup>161</sup> European Insurance and Occupational Pensions Authority, *Report on Costs and charges of IORPs*, 07 January 2015, EIOPA-BoS-14/2667.

European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 54.

<sup>162</sup> Cf. Financial Services Authority, *Quality of advice on pension switching: a report on the findings of a thematic review*, [http://www.fsa.gov.uk/pubs/other/pensions\\_switch.pdf](http://www.fsa.gov.uk/pubs/other/pensions_switch.pdf) (accessed 14 January 2017); Cf. I. Alfon, *To Switch or Not to Switch, That's the Question. An Analysis of the Potential Gains from Switching Pension Provide*, <https://ssrn.com/abstract=427560> (accessed 14 January 2017).

<sup>163</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 52.

<sup>164</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 54.

Instead, EIOPA could opt for a different ‘29th’ or ‘second’ regime in which the PEPP as ‘standard’ EU pension plan may be optionally implemented by EEA Member States into their national 1st Pillar bis, second pillar ‘occupational’ pension laws.<sup>165</sup> EIOPA’s Mapping Exercise shows various 1<sup>st</sup> Pillar bis and second pillar pension products of individual Member States that, apart from not being a ‘personal’ plan in the third pillar, resemble to a large extent the characteristics of the discussed PEPP initiative. Various Member States, for instance, apply to a very large extent the regulation applying to third pillar nationally regulated ‘voluntary pension funds’ to their second pillar ‘mandatory pension funds’.<sup>166</sup> In addition, the PEPP initiative includes IORPs that have an ‘occupational nature’. The idea to allow Member State to extend the PEPP initiative to their existing legal systems, thus, does not innovate pension regulation in individual Member States, but only allows for a standardization and regulatory update of already existing legal systems in individual Member States. This idea is being supported by the fact that the PEPP initiative is based upon a mapping exercise that does not only include third pillar pension products, but also 1st Pillar bis and second pillar pension products.

Even without granting an option in the PEPP initiative that allows Member States to extend the PEPP to their first pillar and second pillar, the PEPP initiative is likely to lead to conversion.<sup>167</sup> The PEPP initiative does not prohibit Member States to unilaterally implement the PEPP initiative to its national first or second pillar regulatory framework and may inspire Member States to extend to a lesser or larger extent features to its ‘national third pillar products’.

An example of the latter is the UCITS Directive, a non-pension initiative harmonizing regulatory standards of investment funds, that has served as an example in regulating the ‘pension management entities’ and ‘depositaries’ for many individual Member States in regulating their national third pillar voluntary pension funds and second pillar mandatory pension funds.<sup>168</sup> The PEPP initiative will lead to regulatory convergence in the pension domain regardless whether on the European level a so-called ‘second initiative’ or ‘29th regime’ will be agreed upon. Allowing for an option in the PEPP initiative, however, might lead to political awareness fostering further discussion in further cooperation and coordination between Member States. In either case, Member States would need to facilitate the applicability of the PEPP as flexible pension product to their social and labour law in accommodating the product in their 1st Pillar bis or second pillar national regulatory framework.

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<sup>165</sup> See H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 20, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>166</sup> Spain: Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulación de los Planes y Fondos de Pensiones (personal pension fund); Poland: Act of 28 August 1997 Law on Organisation and Operation of Pension Funds (open pension fund); Portugal : Decreto-Lei n.º 12/2006 de 20 de Janeiro.

<sup>167</sup> J.J. van Zanden, *Het PEPP: is er nog een pijler op te trekken?*, Pensioen Magazine (2017).

<sup>168</sup> H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 20, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

The PEPP initiative, thus, easily allows Member States to optionally extend the initiative to their national first pillar and second pillar legal regimes.<sup>169</sup> This would gradually lead to a standardization of pension products throughout the pension pillars in Europe in a so-called ‘pensions union’.<sup>170</sup>

### 3.5 Towards PEPP as a Global Brand

The PEPP initiative is a third-pillar personal pension product that does not restrict PEPPs to be marketed to EEA consumers exclusively. Although the EEA does not have the competence to unilaterally decide to extend the PEPP product passport to third countries, it leaves it up to third countries to allow PEPPs to be marketed to their consumers on a ‘private placement’ basis. UCITS, for example, are frequently marketed outside the EEA.<sup>171</sup> Several third countries even have a simplified authorization procedure that allow UCITS to be marketed in their territories.<sup>172</sup> In fact, 40% of all new UCITS sales currently take place outside of the European Union.<sup>173</sup> In South America, UCITS are largely represented in Chile and Peru, whereas Singapore, Hong Kong and Taiwan are the main markets for UCITS distribution in Asia.<sup>174</sup> Promotion of UCITS within the EEA is facilitated by the EEA marketing passport. This UCITSD V passporting regime is, however, not available in third countries. This could be similarly designed for PEPPs. PEPPs could, along with UCITS and investment products such as ELTIFs<sup>175</sup>, be part of extending the UCITS global brand success story to other EEA (third-pillar) investment products.

### 3.6 Conclusion

PEPPs are wrappers of existing (EEA) third-pillar pension products. The product is required to comply with ‘common features’ of voluntary personal pension plans and must fulfill additional mandatory elements, such as a default investment option, limited investment choices and flexible elements that include guarantees, a cap of cost and charges and the switching between PEPP providers. Only allowing EEA regulated third-pillar pension products would ensure that

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<sup>169</sup> See European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, Annex 1-4.

<sup>170</sup> H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 20, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>171</sup> See S.N. Hooghiemstra, *Depositaries in European Investment Law: Towards Harmonization in Europe*, Phd 2017 (forthcoming).

<sup>172</sup> See for Taiwan and Switzerland: C.P Shao, *Taiwan* (E. Wymeersch ed. Kluwer 2012); M. Senn, *Switzerland* (E. Wymeersch ed. Kluwer 2012).

<sup>173</sup> G. Turner, *UCITS Growth Takes Old Problems to New Places*, Financial news, 7 February, 2011; See K. Johannsen, *Jumping the gun: hedge funds in search of capital under UCITS IV*, 5 Brooklyn Journal of Corporate, Financial & Commercial Law 473 (2011); See also P. Dejmek, *The EU Internal Market for Financial Services – A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future*, 15 Columbia Journal of European Law 455, 472 (2009); R. Pozen & T. Hamacher, *Cross-Border Distribution – The Global Fund-Leadership Playoffs: Europe vs. the US*, 18 Luxembourg Fund Review 27 et seq. (2011).

<sup>174</sup> C. D. Christian, *UCITS outside Europe* 450 (D. Frase ed., Sweet & Maxwell 2011).

<sup>175</sup> D.A. Zetzsche, & C.D. Preiner, *ELTIFR versus AIFMD* (D. Zetzsche ed, Kluwer 2015), 164.



PEPP providers cannot enter in regulatory arbitrage by choosing a less well regulated underlying national product as part of a PEPP. Not limiting eligible products to EEA products would mean that PEPP providers are able to use a marketing passport for PEPPs that compete with EEA third-pillar products. The European legislator, however, could be of the opinion that the mandatory and flexible elements provide enough consumer protection as to allow every single type of underlying third-pillar product to be ‘wrapped’ into the PEPP product passport. In addition, EIOPA could opt for a different ‘29th’ or ‘second’ regime in which the PEPP as ‘standard’ EU pension plan may be optionally implemented by EEA Member States into their national first pillar b, second pillar ‘occupational’ pension laws.<sup>176</sup> This would gradually lead to a standardization of pension products throughout the first, second and third pension pillars in Europe in a so-called ‘pensions union’.<sup>177</sup> PEPP could even be part of extending the UCITS global brand success story to other EEA (third-pillar) retirement products.<sup>178</sup>

#### 4 The PEPP (Product) Passport under a PEPP Regulation

##### 4.1. An Internal Market for PEPPs

EIOPA indicated in several policy documents that it believes that the internal market for PEPPs would be substantially enhanced if a PEPP product passport would be introduced.<sup>179</sup>

The TFEU legal basis for a legal instrument would, thus, be the common ‘internal market’.<sup>180</sup> EIOPA refers to a ‘PEPP product passport’.<sup>181</sup> This implies that EIOPA seeks to establish an internal market for PEPPs on the basis of ‘positive integration’.<sup>182</sup>

This approach is logical as national rules for existing PPPs differ widely. EIOPA believes this is due to the fact that - in order to safeguard the interests of personal retirement savers - individual countries have introduced national rules of general good.<sup>183</sup> These rules relate to, amongst others, investment restrictions and requirements with regard to capping cost and

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<sup>176</sup> H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 20, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>177</sup> H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 20, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>178</sup> C. D. Christian, *UCITS outside Europe* 450 (D. Frase ed., Sweet & Maxwell 2011).

<sup>179</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>180</sup> Cf. Arts 53, 62 and 114 TFEU.

<sup>181</sup> Ideas of related to the general principles of the European passport have been partly derived from: Hooghiemstra, S.N., *Depositaries in European Investment Law: Towards Harmonization in Europe*, Phd 2017 (forthcoming).

<sup>182</sup> F.W. Scharpf, *Negative and Positive Integration in the Political Economy of European Welfare States* (G. Marks ed, Sage Publisher 1996), 15-39.

<sup>183</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 13; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 58, 80.

charges.<sup>184</sup> Although the national rules of general good touch upon the free movement of persons<sup>185</sup>, the free movement of establishment/services and the free movement of capital, negative integration by directly invoking the ‘fundamental freedoms’ by means of the CJEU is excluded as Member States in the financial services domain are able to justify obstacles related to establishing an ‘internal market’ for PPPs on the basis of consumer protection (‘the general good’).<sup>186</sup>

Positive integration seems, thus, the only means in which an internal market for personal pensions can be achieved. Before the legal instruments that could be used to establish a European PEPP product passport on the basis of ‘positive integration’ are discussed, the European passport as a concept will be addressed.

#### **4.2. The General Concept of the ‘European Passport’**

The so-called ‘European passport’ is at the heart of the EEA system for financial services. It is a general concept which lays down the conditions for the ‘mutual recognition’ principle. The general idea is that financial products or services that are ‘produced’ (and marketed) in a ‘home Member State’ may, under conditions set out in European legislative acts, be marketed throughout the internal market without incurring further conditions imposed by ‘host Member States’.<sup>187</sup> There are various types of European passports that are currently applied in the EEA, including passports for market infrastructures (CCPs), disclosure/information requirements (ProspectusD, PRIIPR), financial intermediaries (CRD IV, MiFID II) and financial products (IORPD II, UCITS V).

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<sup>184</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 14; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 60.

<sup>185</sup> See, for instance, for the IORPD I/II: H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 22, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>186</sup> D.A. Zetzsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014), 63–66; European Parliament, *Consumer Protection in the EU*, [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/565904/EPRS\\_IDA%282015%29565904\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/565904/EPRS_IDA%282015%29565904_EN.pdf) (accessed 14 January 2017); International Organisation of Securities Commissions, *Objectives and Principles of Securities Regulation for market intermediaries*, <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf> (accessed 14 January 2017); Organisation for Economic Co-operation and Development, *G20 High Level Principles Financial Consumer Protection*, <http://www.oecd.org/dataoecd/58/26/48892010.pdf> (accessed 14 January 2017).

<sup>187</sup> See, for instance, for MiFID I/II: P. Casey & K. Lannoo, *The MiFID Revolution*, ECMI Policy Brief No. 3 (November 2006); J.P. Casey & K. Lannoo, *The MiFID revolution* (Cambridge University Press (2009)); G. Ferrarini & E. Wymeersch, *Investor protection in Europe: corporate law making, the MiFID and beyond* (Oxford University Press 2006); International Organisation of Pension Supervisors, *Supervision of Pension Intermediation*, <http://www.iopsweb.org/WpNo17Web.pdf> (accessed 14 January 2017).

The underlying concepts of the European passport are ‘risk asymmetry’ and ‘economies of scope and scale’.<sup>188</sup>

The ‘risk asymmetry’ component is that under a ‘mutual recognition’ approach, home Member States might be inclined by political and economic motivations to stimulate their financial services/products that are ‘produced’ in their Member State (production state) by subjecting their financial intermediaries and products to a minimum set of regulation and/or lax enforcement of the regulatory framework in place.<sup>189</sup> If those products and services are primarily marketed outside of that home Member State, the positive effects of lax regulation and supervision are being enjoyed by the home Member State as ‘production state’, whereas the negative effects of that are to be borne by ‘distribution states’, i.e. the host Member States. This might lead to so-called ‘risk asymmetry’ that has been evidenced by the ‘icesave scandal’<sup>190</sup> that took place in which Icelandic Supervisory Authorities with lax supervision allowed badly capitalized credit institutions to offer deposits to Dutch and British customers based upon the European passport to boost their domestic financial services industry.<sup>191</sup>

The idea of the exploitation of economies of scope of scale of the European passport is that financial service intermediaries under the European passport are able to be active throughout the EEA.<sup>192</sup> For small Member States, this has as an advantage that their financial services intermediaries may develop to a larger extent as, for example, Liechtenstein intermediaries can offer their services/products not to a market of 36,000 people but a market comprising of 500 million consumers.<sup>193</sup> Without the existence of the European passport, it would have not been

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<sup>188</sup> D.A. Zetsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014), 54-60, 62-63; M. Lehmann & D.A. Zetsche, *Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK*, <https://ssrn.com/abstract=2841333> (accessed 14 January 2017); D.A. Zetsche & T.F. Marte, *The AIFMD’s Cross-Border Dimension, Third-Country Rules and the Equivalence Concept* 474 (D. Zetsche ed, Kluwer 2015).

<sup>189</sup> D.A. Zetsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014), 62-63.

<sup>190</sup> I. Fridriksson, *The banking crisis in Iceland in 2008*, <http://www.bis.org/review/r090226d.pdf> (accessed 14 January 2017); See also House of Commons, Treasury Committee, Banking Crisis: The impact of the failure of the Icelandic banks – Fifth Report of Session 2008-09, 4 April 2009; Stefansson & T. Saethorsson, Cross-border issues in EU Deposit Guarantee Schemes: With a focus on the Icelandic case, 63-82, [http://pure.au.dk/portal-asb-student/files/12991/Thesis\\_without\\_Appendix.pdf](http://pure.au.dk/portal-asb-student/files/12991/Thesis_without_Appendix.pdf) (accessed 14 January 2017).

<sup>191</sup> E.G. Gunnarsson, *The Icelandic Regulatory Responses to the Financial Crisis*, 1 *European Business Organization Law Review* 139 (2011); S. Benediktsson, J. Danielsson & G. Zoega, *Lessons from a collapse of a financial system*, <https://www.tcd.ie/Economics/assets/pdf/version-20-ben-dan-zoega-revised.pdf> (accessed 14 January 2017); Zhao Li, *Securities Regulation in the International Environment*, 110-115, <http://theses.gla.ac.uk/691/1/2009zhaoliphd.pdf> (accessed 14 January 2017); M. Guðmundsson, *The Fault Lines in Cross-Border Banking: Lessons From the Icelandic Case*, *OECD Journal Financial Market Trends*, Issue 2 (2011).

<sup>192</sup> D. Dietrich, *Transaction cost economics and beyond: towards a new economics of the firm* (Routledge 1994); See also K. Lannoo, *Regulatory Challenges for the EU Asset Management Industry*, ECMI Policy Brief, No. 15 (April 2010), [https://www.files.ethz.ch/isn/115117/015\\_Lannoo%20on%20Asset%20Management.pdf](https://www.files.ethz.ch/isn/115117/015_Lannoo%20on%20Asset%20Management.pdf) (accessed 14 January 2017).

<sup>193</sup> D.A. Zetsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014), 54-60.



worthwhile for any financial intermediaries to obtain an authorization to market financial services/products in Liechtenstein as the costs would exceed the benefits.<sup>194</sup> From the perspective of the large Member States, the competition of intermediaries of small Member States in marketing financial products/services in their domestic market leads to more competition, more innovation and financial services/products of a higher quality for lower prices.<sup>195</sup>

To facilitate the ‘mutual recognition’ approach and overcome ‘risk asymmetry’, the European passport has to be based upon a harmonization of substantive law and financial supervision.<sup>196</sup>

### **4.3. Positive Integration, Legal Instruments and the Lamfalussy Procedure**

For the purpose of positive integration in the EEA to establish a product passport there are several legal instruments available to achieve a ‘PEPP internal market’. Based upon Articles 53, 62 and 114(1) TFEU, 114(1) TFEU, the European Parliament and the Council may adopt measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market. Typically, financial regulation on the EEA level is being based upon the so-called ‘Lamfalussy Procedure’. Before the Lamfalussy procedure will be addressed, first the choice of policy instruments on the EEA level will be introduced.

#### **4.3.1. The Choice of EU Policy Instruments**

The legal acts of the EU are listed in Article 288 TFEU. There are regulations, directives, decisions, recommendations and opinions. EU institutions may adopt any of these legal acts if they are empowered to do so by the Treaties<sup>197</sup>. The sources of law laid down in Article 288

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<sup>194</sup> See, for instance, the broad discussion about the European passport of financial intermediaries in the UK after the Brexit: K. Lannoo, EU Financial Market Access after Brexit, CEPS Policy Brief, September 2016, [https://www.ceps.eu/system/files/Brexit%20and%20the%20financial%20sector\\_0.pdf](https://www.ceps.eu/system/files/Brexit%20and%20the%20financial%20sector_0.pdf) (accessed 14 January 2017); D. Schoenmaker, The UK Financial Sector and EU Integration after Brexit: The Issue of Passporting, <https://ssrn.com/abstract=2844253> (accessed 14 January 2017); L. Noonan & J. Brunsdon, *Banks fear chill wind of ‘passport’ freeze*, Financial Times, (21 September 2016); D. Gros, *The Economics of Brexit: It’s not about the Internal Market*, <https://www.ceps.eu/publications/economics-brexit-it%E2%80%99s-not-about-internal-market> (accessed 14 January 2017); International Monetary Fund, *Macroeconomic implications of the United Kingdom leaving the European Union*, IMF Country Report No. 16/169 (2016), <https://www.imf.org/external/pubs/ft/scr/2016/cr16169.pdf> (accessed 14 January 2017); K. Lannoo, *Brexit and the City*, <https://www.ceps.eu/publications/brexit-and-city> (accessed 14 January 2017); K. Lannoo, *Britain’s Finance Industry Needs the EU*, Wall Street Journal (26 January 2016).

<sup>195</sup> D. Dietrich, *Transaction cost economics and beyond: towards a new economics of the firm* (Routledge 1994); K. Lannoo, EU Retail Financial market Integration: Mirage Or Reality?, ECRI Policy Brief No. 3 (June 2008).

<sup>196</sup> K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004), 4.

<sup>197</sup> ‘Treaties’ on the EU level include the Treaty on European Union (TEU); Treaty on the Functioning of the European Union (TFEU); the protocols related to these treaties; the Character of Fundamental Rights of the European Union; the Treaty Establishing the European Atomic Energy Community (Euratom); international agreements; the principles of proportionality and subsidiarity of Union law and EU secondary legislation.

TFEU are referred to as ‘secondary legislation’ as it is based upon the Treaties that are ‘primary legislation’.

Articles 289, 290 and 291 TFEU establish a hierarchy of secondary legislation between legislative acts, delegated acts and implementing acts. Legislative acts are adopted through the ordinary or a special legislative procedures, whereas delegated acts are non-legislative acts of general application which supplement or amend certain non-essential elements of a legislative act.<sup>198</sup> Delegated acts may be delegated to the European Commission by the European Parliament and the Council.<sup>199</sup> The latter being referred to as the ‘legislator’ sets out the objectives content, scope and duration of the delegation in the legislative act and the conditions to which the delegation is subject.<sup>200</sup> Implementing acts are adopted by the European Commission if uniform conditions for implementing legally binding acts are needed. In specific cases which are duly justified and in areas of common foreign and security policy, the Council may only adopt implementing acts.<sup>201</sup>

There are under Article 288 TFEU various types of EU secondary legislation. The legal acts in the financial services domain include regulations, directives, decisions, recommendations and opinions.

Regulations function as a ‘European law’, i.e. no implementation on the Member State level is necessary and they are directly enforceable in all Member States (self-executing). Regulations have the object of maximum harmonization<sup>202</sup> and leave no discretion for ‘goldplating’<sup>203</sup> by Member States.<sup>204</sup> They are designed to ensure uniform application of EU law in all Member States and supersede national laws incompatible with their substantive provisions.<sup>205</sup>

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<sup>198</sup> European Commission, *Better Regulation "Toolbox"*, Tool #15: The choice of policy instruments, 87, [http://ec.europa.eu/smart-regulation/guidelines/docs/br\\_toolbox\\_en.pdf](http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf) (accessed 14 January 2017).

<sup>199</sup> See for an overview how the mechanisms work out under IORPD II: A. van den Brink & H. van Meerten, *EU Executive Rule-Making and the Second Directive on Institutions for Occupational Retirement Provision*, 12 UU Law Review 1 (2016).

<sup>200</sup> European Commission, *Better Regulation "Toolbox"*, Tool #15: The choice of policy instruments, 87, [http://ec.europa.eu/smart-regulation/guidelines/docs/br\\_toolbox\\_en.pdf](http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf) (accessed 14 January 2017).

<sup>201</sup> Article 291 TFEU.

<sup>202</sup> European Commission, *Better Regulation "Toolbox"*, Tool #15: The choice of policy instruments, 87, [http://ec.europa.eu/smart-regulation/guidelines/docs/br\\_toolbox\\_en.pdf](http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf) (accessed 14 January 2017).

<sup>203</sup> Directorate General for Internal Policies, ‘*Gold-plating in the EAFRD – To what extent do national rules unnecessarily add to complexity and as a result, increase the risk of errors?*’, IP/D/ALL/FWC/2009-056, 27 February 2014, [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/490684/IPOL-JOIN\\_ET%282014%29490684\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/490684/IPOL-JOIN_ET%282014%29490684_EN.pdf) (accessed 14 January 2017); W. Voermans, *Gold-plating and double banking: an overrated problem?* 79-88 (H. Snijders & S. Vogenauer eds. Sellier European Law Publishers 2009); J.H. Jans & L. Squintani, A. Aragão, R. Macrory & B.W. Wegener, ‘*Gold plating*’ of European Environmental Measures, 6.4. Journal of European Environmental and Planning Law 417-435.

<sup>204</sup> Art. 288 TFEU.

<sup>205</sup> European Commission, *Better Regulation "Toolbox"*, Tool #15: The choice of policy instruments, 87, [http://ec.europa.eu/smart-regulation/guidelines/docs/br\\_toolbox\\_en.pdf](http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf) (accessed 14 January 2017).

Directives are a European legislative act that obliges Member States to achieve a result. This requires Member States to implement the act on the Member State level. How the Directive is implemented depends upon whether the Directive has maximum or minimum harmonization as its objective that is usually being taken from the recitals and other policy documents upon adopting the Directive.<sup>206</sup> Directives, however, leave to national authorities the choice of form and methods how to implement the act. Member States are given some discretion in implementing directives to take account of specific national circumstances. Member States are, however, obliged by Article 4(3) TFEU to guarantee the effectiveness of EU law in accordance with the principle of sincere cooperation. Directives that are not timely implemented or have led to a 'wrong' implementation may have 'direct effect', i.e. may be directly invoked as if it was a law in itself.<sup>207</sup>

Decisions are binding in its entirety to those to whom they are addressed. Individuals may invoke rights to Member States, natural or legal persons conferred by a decision.

Communications from the European Commission and advices/guidelines given by the ESA's<sup>208</sup> are not legally binding in itself and do not confer any rights or obligations on those to whom they are addressed by, in particular, provide guidance as how EU law has to be interpreted. In the financial services domain these comprise of communications from the European Commission and advices/guidelines given by the ESA's<sup>209, 210</sup>. A Commission Communication is legally not binding and always leads to minimum harmonization that allows discretion to Member States how to implement the Communication in their national law.<sup>211</sup> ESA Guidelines are legally not binding in itself, unless any other legislative act explicitly delegates competences to ESA's related to a specific matter to be clarified by an ESA guidelines.<sup>212</sup> ESA

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<sup>206</sup> C. Gerner-Beuerle, *United in diversity: maximum versus minimum harmonization in EU securities regulation*, 3 Capital Markets Journal 317 (2012).

<sup>207</sup> See Francovich case, joined cases C-6/90 and C-9/90); See also the Faccini Dori Case C-91/92, ECR, p. I-3325 et seq., point 25).

<sup>208</sup> See Art. 288 TFEU; European Commission, *Better Regulation "Toolbox"*, Tool #15: The choice of policy instruments, 87, [http://ec.europa.eu/smart-regulation/guidelines/docs/br\\_toolbox\\_en.pdf](http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf) (accessed 14 January 2017).

<sup>209</sup> The ESA's are EIOPA, ESMA and EBA.

<sup>210</sup> See Art. 288 TFEU; European Commission, *Better Regulation "Toolbox"*, Tool #15: The choice of policy instruments, 87, [http://ec.europa.eu/smart-regulation/guidelines/docs/br\\_toolbox\\_en.pdf](http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf) (accessed 14 January 2017).

<sup>211</sup> The Financial Services Action Plan ('FSAP') was an European Union's attempt to create a single market for financial services by harmonizing financial services within the EU to a larger degree. The FSAP was initiated in 1999 and its implementing measures were completed by 2004.

See, for example, the simplified prospectus under UCITS III: Commission staff working document, Impact Assessment - Brussels, accompanying the Proposal for a Directive of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) {COM(2008) 458} {SEC(2008) 2264} SEC(2008) 2263, 57- 59.

<sup>212</sup> See Art. 290, 291 TFEU.

Advice is to be asked by the European Commission prior to adopting Level 1 and Level 2 instruments. The advice concerned Level 2 is only mandatory in the cases that are expressly indicated in Level 1 instruments.. The European Commission, however, remains to be responsible and is not legally obliged to follow up the ESA advice.

#### **4.3.2. The Lamfalussy Process**

In the Post-FSAP era<sup>213</sup>, the so-called ‘Lamfalussy procedure’ is being used for EEA financial service initiative in fostering harmonization in pursuing the internal market and the recent ‘capital markets union initiative’. Positive integration is sought by means of introducing a ‘PEPP product passport’ on the basis of the ‘internal market’ that requires a qualified majority to adopt measures concerned with the EU.<sup>214</sup> The Lamfalussy framework is the legislative framework on which a European passport is being based. The Lamfalussy procedure was being developed to accelerate the speed of accomplishing an internal market for financial services.<sup>215</sup> The framework is being structured in four levels. The so-called level 1 legislative acts are being agreed upon between the Council of ministers and the involvement of the European Parliament. By means of a Regulation or a Directive the general framework including the general principles to be regulated are being set out. Directives and regulations as ‘binding-acts’ under the Lamfalussy process, require democratic control and ensure that legislative competences are delegated to European institutions subject to this control<sup>216</sup>. At level 2, the European Commission with the assistance of the ESA’s elaborate the certain aspect as indicated in the level 1 initiative in Commission directives or regulations. At level 3, a committee comprising of the ESA’s advice on the regulation and implementing the supervision. ESA’s may publish guidelines deliberately or are asked by level 1 or level 2 instruments to do so. At level 4, the European legislation is implemented by the Member States and the European Commission ensures that this is done correctly, if necessary by commencing an infringement procedure pursuant to Article 258 TFEU.

#### **4.4. Designing a European Product Passport for PEPPs**

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<sup>213</sup> See K. Lee, *Investor Protection in European Union: Post FSAP Directives and MiFID*, <https://ssrn.com/abstract=1339305> (accessed 14 January 2017); European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products*, 7, [http://ec.europa.eu/dgs/health\\_food-safety/dgs\\_consultations/ca/docs/swd\\_consumer\\_protection\\_thirds\\_pillar\\_pensions\\_en.pdf](http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf) (Accessed 14 January 2017). Directorate General for Internal Policies, *Consumer Protection Aspects of Financial Services*, IP/A/IMCO/ST/2013, 07 February 2014, [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/507463/IPOL-IMCO\\_ET%282014%29507463\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/507463/IPOL-IMCO_ET%282014%29507463_EN.pdf) (accessed 22 December 2016).

<sup>214</sup> See Arts 53, 62 and 114 TFEU.

<sup>215</sup> K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004).

<sup>216</sup> K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004).

European passports are based upon the Lamfalussy procedure and addresses the harmonization of both substantive law and a financial supervisory framework. The primary legal instruments being used for harmonization of both at Level 1 are directives and regulations.

The first generation of ‘product passports’, including IORPs and UCITS under the IORPD and UCITSD, have been adopted as a directive rather than a regulation. Although both legal instruments take precedence over Member State laws, the nature of the instrument is entirely different. Regulations as ‘European laws’ have direct effect, whereas directives offer Member States the possibility to choose the means by which the objectives set out by the directive would be achieved. The directive as a legal instrument was chosen over regulations under the first generation of ‘product passports’ as directives by nature accommodate the principles of subsidiarity and proportionality between EU law and institutions and national law and institutions on the Member State level better.

As a consequence of regulating by directives, Member States were responsible for transposing EU law into national law. The objective of (product) regulation in the IORPD and UCITSD were minimum harmonization. As a result of this characteristic, Member States had the possibility to set higher standards, provided that they do not discriminate, i.e. restrict access from financial products in Member States that are satisfied with the minimum standard set out by the directive.

Many Member States made use of their discretion under the IORPD and UCITSD to set higher standards or abiding to different interpretations of similar terms resulting in the hindrance of an internal market of IORPs and UCITS.

A decade after the implementation of IORPD, this is exemplified by IORPs of which currently not even 100 are operating on a cross-border basis, whereas it took for UCITS until UCITSD III till it became a success.<sup>217</sup> Although the EU and the US are similar in terms of GDP, the average UCITS was, until the introduction of UCITSD IV, five times smaller than its US counterparts (mutual fund).<sup>218</sup>

Post-FSAP, directives and regulations adopted at Level 1 have the nature of ‘maximum harmonization’. Unsurprising, the tendency on the European level is to establish Level 1 instruments by means of a regulation that prevent ‘goldplating’ by national Member States.<sup>219</sup>

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<sup>217</sup> U. Klebeck, *Interplay between AIFMD and the UCITSD* 96-97 (D. Zetsche ed, Kluwer 2015).

<sup>218</sup> European Commission, *Green Paper on the Enhancement of the EU Framework for Investment Funds of 12 July 2005 (SEC(2005) 947)*, [http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background\\_en.pdf](http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf) (accessed 14 January 2017).

<sup>219</sup> See also the different implementations of the AIFMD: See D.A. Zetsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014); Cf. W. Voermans, *Gold-plating and double banking: an overrated problem?* 79-88 (H. Snijders & S. Vogenauer eds. Sellier European Law Publishers 2009); J.H. Jans & L. Squintani, A. Aragão, R. Macrory & B.W. Wegener, ‘Gold plating’ of European Environmental Measures, 6.4. Journal of European Environmental and Planning Law 417-435.

Recent examples of product regulation established as a regulation include the ELTIFR, EuSEFR, EuVECAR and the proposed MMFR.<sup>220</sup> Having the nature of product regulation, it is expected the PEPP initiative will also be established as a Regulation.

#### **4.4.1. The Harmonization of Substantive Law**

The harmonization of PEPP providers, distributors and products could be based upon European legislative instruments adopted at one or more levels.

##### **4.4.1.1. Level 1**

Generally, European passports for financial products and intermediaries are structured as follows. At level 1, the framework Directive/Regulation adopted usually includes provisions governing the:

- Object, Definitions & Scope
- Authorization
- Operational Conditions
- Cross-border activity (European Passport)
- Enforcement (EFSF vs. national Competent Authorities)
- Sanctions

The PEPP initiative addressed PEPPs. For that purpose, the most important definition to be clarified is what a PEPP is. Definitions, amongst others, would be needed for home and host Member States, PEPP providers, distributors, depositaries/custodians and consumers.

The authorization of the PEPP as a product primarily would primarily depend upon the authorization of the PEPP provider under sectoral EEA legislation and the compliance of the product with the operational conditions laid down in the PEPP initiative.

The PEPP initiative is based upon already existing EEA legislation governing PEPP providers, distributors and depositaries/custodians. Operational conditions, thus, primarily would need to clarify the additional responsibilities of these intermediaries related to the manufacturing and distribution of PEPPs. Specific operational conditions that would partly be based upon existing EEA legislation are provisions related to sales regulation and disclosure.

The PEPP initiative would need to include cross-border activity. The PEPP is a financial product and as such the initiative would need to contain provisions modelled after UCITS related to the cross-border marketing of PEPPs. This would include a notification procedure of the home Member State in which the PEPP is authorized and the notification to host Member States in which the PEPP is intended to be marketed.

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<sup>220</sup> S.N. Hooghiemstra, *Wat is een beleggingsinstelling onder de AIFM-richtlijn?*, 3 Ondernemingsrecht 24 (2014).

Provisions related to enforcement primarily require the national Competent Authorities of the home Member State to take measures if PEPP providers/distributors do not comply with the PEPP regulation. Enforcement also addressed the cooperation between home and host Member States and the cooperation between national Competent Authorities and the ESA's.

Sanctions include fines based upon administrative law and, in the worst case the European passport for distributing PEPPs could be revoked.

#### 4.4.1.2. Level 2

Level 1 could also include provisions delegating responsibilities to the European Commission to adopt Directive/Regulations clarifying the general framework set out in level 1. Considering, the 'wrapper' nature of the PEPP initiative that is largely based upon already existing EEA legislation applying to PEPP providers, this would be limited. Level 2 measures could primarily include provisions related to sales regulation/disclosure. For example, a Regulation/Directive could be adopted by the European Commission modelled after the PRIIPR for the information provision to consumers in the accumulation phase.<sup>221</sup>

#### 4.4.1.3. Level 3

Guidelines issued by ESAs, such as EIOPA, are likely to play a bigger role. Guidelines could include additional explanation of examples what PEPPs under the PEPP definition are.<sup>222</sup> Also the format of disclosure regulation/disclosure regulation required under the PEPP initiative could be further elaborated by EIOPA. Finally, the European Commission would be responsible for the correct implementation of the PEPP initiative by individual Member States.

#### 4.4.1.4. Level 4

At level 4, the European legislation is implemented by the Member States and the European Commission ensures that the required PEPP implementation is done correctly. If necessary, the European Commission commences an infringement procedure pursuant to Article 258 TFEU.

### 4.4.2. The Harmonization of Financial Supervision

The financial supervision under a PEPP product passport would be based upon (1) Home Country Control and (2) the European System of Financial Supervision.

#### 4.4.2.1. Home Country Control

Traditionally underpinning European (product) passport is the principle of home country control, i.e. the Member State where the financial product is being registered/authorized or the financial intermediary has its statutory/real seat is responsible for carrying out the supervision

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<sup>221</sup> D.A. Zetsche, D.A. & D. Eckner, D., *Investor Information and Reporting* (D. Zetsche ed, Kluwer 2015).

<sup>222</sup> See, for example, the clarification of AIFs under the ESMA guidelines: European Securities Markets Authority, Guidelines on key concepts of the AIFMD, ESMA/2013/611, 13 August 2013.



of the product or intermediary. The European passport requires that the Competent Authorities of the host Member State trust the supervision being carried out by the home Member State. Competent Authorities in host Member States, i.e. the Competent Authorities in Member States where the service provider may offer its products, have frequently expressed doubts regarding this equivalence.<sup>223</sup> The financial crisis and events like the icesave scandal<sup>224</sup> lead to a larger degree of cooperation to supervise the activities of entities from other Member States by the establishment of the European System of Financial Supervision.

#### 4.4.2.2. European System of Financial Supervision

The European System of Financial Supervision consists of the ESRB carrying out macro-prudential supervision<sup>225</sup> and three ESAs (EBA, EIOPA and ESMA) that carry out micro-prudential supervision on a sectoral basis.<sup>226</sup> Especially, the establishment of the ESAs are for a future PEPP initiative of particular importance. In 2011, the ESAs received more binding legal powers related to rulemaking, the implementation of EU law, emergency powers, conflict resolution and restricting certain financial products.<sup>227</sup>

ESA's have an advisory function in the rulemaking process for developing Level 1 directives or regulations. In addition, ESAs are involved in a preparatory and advisory capacity related to the Level 2 implementing acts that are adopted by the European Commission on the basis of Article 290 TFEU. The ultimate decision lies, however, in principle with the European Commission.

This second important competence relates to verifying compliance of the implementation of the directives and regulations in the national jurisdictions, including the Regulatory technical standards by ESAs.<sup>228</sup> Non-compliance is, based upon Article 258 TFEU, to be identified by the European Commission and to be brought before the CJEU. According to the ESA Regulations, the identification is being attributed to ESAs that 'shall act' upon non-compliance and dialogues between ESAs and national Competent Authorities shall take away most issues. After the dialogue, national Competent Authorities that continue to be non-compliant may

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<sup>223</sup> K. Lannoo & M. Levin, *Securities Market Regulation in the EU -Everything You Always Wanted to Know about the Lamfalussy Procedure*, CEPS Research Report in Finance and Banking, No. 33, (May 2004), 14.

<sup>224</sup> E. Wymeersch, Eddy, *Europe's New Financial Regulatory Bodies*, 5, <http://ssrn.com/abstract=1813811> (accessed 14 January 2017); E. Wymeersch, *The institutional reforms of the European Financial Supervisory System, an interim Report*, WP 2010-01 (2010).

<sup>225</sup> N. Kost - de Sevres & L. Sasso, *The new European financial markets legal framework: a real improvement? An analysis of financial law and governance in European capital markets from a micro- and macro-economic Perspective*, 7 Capital Markets Law Journal 30 (2011).

<sup>226</sup> See the ESRB Regulation, EBA Regulation EIOPA Regulation, ESMA Regulation, ECB Regulation and the ESRB Regulation.

<sup>227</sup> H. van Meerten & A.T. Ottow, *The proposals for the European Supervisory Authorities (ESAs): the right (legal) way forward?*, 1/2 TvFR 5 (2010).

<sup>228</sup> J. Doelder & I.M. Jansen, *Een nieuw Europees toezichtraamwerk*, 1/2 TvFR 17 (2010).



receive a formal opinion of the European Commission that might be based upon the recommendation of the ESA and is subject to review by the CJEU.<sup>229</sup>

Emergency situations, such as developments that jeopardize the orderly functioning and integrity of the financial markets, that are declared by the Council of ministers may be addressed 'decision' to the ESAs concerned. A recommendation or a request may be made by the ESRB or the ESA and ESAs may require national Competent Authorities to take action to ensure that the Level 1 measures are being complied with. In the absence of a Council decision, the ESA may also adopt emergency measures in exceptional circumstances when a serious danger arises to the orderly functioning of the markets or to financial stability. If the national authority does not respond to this request, ESAs may take direct actions that target the financial institutions in that Member State.<sup>230</sup>

Earlier experiences under European passport arrangements have shown that Competent Authorities sometimes experience difficulties in reaching agreements. The ESA Regulations have provided a mechanism for dispute resolution between Competent Authorities to be settled by a decision of an ESA. This may, however, only be used for matters that are precisely expressed in a Level 1 document to be open for mediation and dispute resolution.<sup>231</sup> The procedure consists of a 'reconciliation phase' and a 'decision phase'. The decision made by ESAs are addressed to national Competent Authorities. In the case of non-compliance, however, ESAs may directly target financial institutions in individual Member State to ensure compliance with Union law.

ESAs on the basis of Article 9 of the ESA Regulations are attributed with the power to prohibit or restrict certain 'financial activities', including financial products. This power is related to activities that threaten the 'orderly functioning and integrity of financial markets or the stability of whole or part of the financial system in the Union'. Decision taken by ESAs directly affect the financial intermediaries conducting those financial activities without the involvement without any intervention of the national Competent authority.

#### **4.5. Conclusion**

EIOPA indicated in several policy documents that it believes that the internal market for PEPPs would be substantially enhanced if a PEPP product passport would be introduced.<sup>232</sup>

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<sup>229</sup> E. Ferran, *Understanding the New Institutional Architecture of EU Financial Market Supervision*, Paper No. 29/2011 (2011).

<sup>230</sup> H. van Meerten & A.T. Ottow, *The proposals for the European Supervisory Authorities (ESAs): the right (legal) way forward?*, 1/2 TvFR 5 (2010).

<sup>231</sup> E. Ferran & K. Alexander, *Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board*, PAPER NO. 36/2011(2011).

<sup>232</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006.

To facilitate the ‘mutual recognition’ approach and overcome ‘risk asymmetry’, the European passport has to be based upon a common European substantive legislative and supervisory framework. In line with recent legal initiatives, including the ELTIFR, EuSEFR, EuVECAR and the proposed MMFR, it is expected the PEPP initiative will also be established as a regulation. The regulation as legislative instrument prevents Member States from ‘goldplating’ the PEPP initiative that could result in the hindrance of an ‘internal market for PEPPs’. The Level 1 harmonization of PEPP providers, distributors, products and sales regulation may be further complemented by legislative implementing acts adopted by the European Commission (Level 2) or any technical measures/guidelines adopted by ESAs. Applying the European System of Financial Supervision introduced in 2011 to PEPPs would ensure that the PEPP initiative would also be adequately enforced by home/host Member States and the supranational ESAs.

## **5 PEPP - Governance**

The PEPP initiative is addressing the full governance of the PEPP involving intermediaries (PEPP providers, distributors and depositaries), the position of consumers, the PEPP product and sales/disclosure regulation.<sup>233</sup>

### **5.1 The PEPP Initiative – Intermediary, Product & Sales Regulation**

Although EIOPA focusses on introducing a PEPP product passport modelled after the UCITSD V, the PEPP initiative is intended to regulate not only the product, but also PEPP providers, distributors, depositaries/custodians and disclosure/information to be provided to consumers.

The PEPP initiative will be built upon a regulatory cocktail comprising of intermediary, product and sales regulation. Despite the ‘product regulation character’, i.e. regulating PEPP as a financial product on the EEA level, the PEPP initiative will be a modern set of EEA legislation.

Recently, the European legislature has the focus on so-called ‘intermediary regulation’. Initiatives, such as the AIFMD and MiFID II, do not focus on regulating financial products. The idea is that regulators are too slow to regulate each new product due to the innovative speed

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<sup>233</sup> See for the regulation financial intermediaries, in particular depositaries: Hooghiemstra, S.N., *Depositaries in European Investment Law: Towards Harmonization in Europe*, Phd 2017 (forthcoming); A. Byrne, A., D. Harrison & D. Blake, *Defined Contribution Pensions: Dealing with the Reluctant Investor: Innovation and Governance in DC Pension Investment*, [http://www.pensions-institute.org/reports/PI\\_DC\\_Investment\\_Final.pdf](http://www.pensions-institute.org/reports/PI_DC_Investment_Final.pdf) (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 9-10; Cf. Organisation for Economic Co-operation and Development, *Guidelines on Pension Fund Governance*, <http://www.oecd.org/dataoecd/18/52/34799965.pdf> (access 21 December 2016); International Organisation of Pension Supervisors, *Supervising default investment funds*. IOPS Working Papers on Effective Pensions Supervision, No.18 (2012).

and force of the financial industry.<sup>234</sup> Instead, focusing on regulating intermediaries ensures that only skilled and honest people are employed by financial intermediaries that are required by EEA legislation to have sufficient resources.<sup>235</sup> The recent intermediary regulation approach touches upon the behavior of the market actors (source) and only addresses the possible adverse consequences of the product to a limited extent.

This modern ‘intermediary regulation’ approach follows up and complements the ‘older’ ‘product regulation’ approach that was popular during the 80s, 90s and the early 2000s.. The IORPD I and UCITSD I are examples of the ‘product regulation’ approach.. Due to difficulties in examining how fund managers and the governing bodies of IORPs and their depositaries/custodians in the EEA were regulated, the harmonization in these initiatives focused on harmonizing the product and merely subjected the intermediaries involved to ‘principles-based’ regulation.<sup>236</sup> The rationale behind ‘product regulation’ is that by regulating the manufacturing and distribution of financial products, financial intermediaries are not able to market financial products that are jeopardizing consumers/investors.

Disclosure/marketing regulation is the least ‘paternalistic’<sup>237</sup> variant of EEA regulation. Although recently disclosure/marketing regulation is being used in conjunction with, in particular, intermediary regulation<sup>238</sup>, disclosure/marketing regulation originally had the very neo liberal idea of letting investors/consumers decide for themselves whether a particular financial service/product suits their needs.<sup>239</sup> The primary example of an EEA regulatory initiative merely focusing on disclosure is the ProspectusD. Pre-AIFMD, certain closed-end AIFs were only required on the EEA level to provide a prospectus to its (retail) investors.<sup>240</sup>

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<sup>234</sup> See D.A. Zetsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D. Zetsche ed, Kluwer 2015), 127; See also J.-P., Casey & K. Lannoo, *The Mifid Revolution: A Policy View*, 7 Competition and Regulation in Network Industries 519 (2006); see also A. Cygan & E. Szyszczak, *The Controversy and Confusion over Mifid*, 25 International Financial Law Review 14-21 (August 2006).

<sup>235</sup> See D.A. Zetsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D. Zetsche ed, Kluwer 2015), 127.

<sup>236</sup> See J. Black, *Forms and Paradoxes of Principles Based Regulation*, LSE Law, Society and Economy Working Papers No. 13 (2008).

<sup>237</sup> See on paternalism: D.A. Zetsche, D., *Prinzipien der kollektiven Vermögensanlage* § 8 A. I (Mohr Siebeck 2015).

<sup>238</sup> See, for example, UCITS ManCos and AIFMs under UCITSD V and the AIFMD.

<sup>239</sup> See for behavioral economic studies for PEPPs: European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 46.

<sup>240</sup> Member States, however, could ‘goldplate’ these EEA requirements. Closed-end AIFs were pre-AIFMD, for instance, completely exempted from any intermediary and product regulation under the Investmentgesetz in Germany. AIFMs only had disclosure duties towards investors; See D.A. Zetsche, D., *Prinzipien der kollektiven Vermögensanlage* § 16 A. IV. 2. (Mohr Siebeck 2015).

The PEPP initiative must combine the best of the ‘three worlds’. It will be a modern comprehensive regulatory framework comprising of intermediary, product and sales regulation.<sup>241</sup> Other than product regulation under UCITSD I and IORPD I, the PEPP initiative does not regulate the PEPP product to deal with the ‘symptoms’ of the adverse consequences of the involvement of intermediaries on the European financial markets. The PEPP is a ‘wrapper product’ based upon PEPP providers, distributors and depositaries/custodians that are already regulated on the EEA level. In this regard, the PEPP is similar to the PRIIPR that is a cross-sectoral sales/disclosure initiative providing cross-sectoral comparable short form information disclosures. It can be compared to the ELTIFR to an even larger extent as the ELTIFR regulates retail AIFs and is, to a large extent, based upon the intermediary, product and sales/disclosure regulation under the AIFMD.

The PEPP initiative, where necessary, subjects these intermediaries to additional regulation that are tailor-made for PEPPs. As PPPs under the regulation of the individual Member States within the EEA are already based upon intermediary regulation adopted under the AIFMD, UCITSD V, MiFID II, IORPD II, CRD IV and Solvency II<sup>242</sup>, it is both not necessary and also too cumbersome to make a stand-alone regulatory regime for PEPP providers, distributors and depositaries/custodians.<sup>243</sup> The product regulation under PEPP, thus, primarily has as its purpose to define the scope of the initiative rather than the traditional approach under EEA legislation of substituting intermediary regulation by product regulation to restrict PEPP providers in offering certain financial products to customers on a cross-border basis in the EEA. In particular, as all underlying third-pillar products are already being marketed under EEA legislation to customers. The PEPP, however, delineates itself from other initiatives, such as UCITSD V, IORPD II and Solvency II, by limiting those financial products under these initiatives to consumers that have an exclusive retirement objective.<sup>244</sup> The retirement objective required under the PEPP initiative that serves as a ‘wrapper’ for already existing financial products under the EEA legislative framework is particularly highlighted under the proposed disclosure/sales regulation.<sup>245</sup> Like under IORPD II, 1bis pillar and second pillar pensions, the PEPP disclosure/sales regulatory regime is adjusted to the ‘PEPP life cycle’. The PEPP initiative focusses on a disclosure regime that accommodates the needs of consumers throughout the life cycle of a PEPP and includes pre-contractual information, information in the

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<sup>241</sup> See D.A. Zetsche & T.F. Marte, *AIFMD versus MiFID II/MIFIR: Similarities and Differences* (D. Zetsche ed, Kluwer 2015), 127.

<sup>242</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341.

<sup>243</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 11-12.

<sup>244</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7.

<sup>245</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 25.

ongoing or accumulation phase and pre-retirement information that has to be provided in the payout phase.<sup>246</sup>

Now this Report will elaborate in more detail how PEPP providers, distributors and depositaries already regulated under the EEA legislative framework could be included in the PEPP initiative, the disclosure/sales regulation to be expected and the position of the consumers.

## **5.2 Intermediary Regulation**

EIOPA identified that the PEPP initiative should differentiate between requirements targeting the manufacturing of PEPPs by PEPP providers and the marketing of PEPPs by distributors.<sup>247</sup> For this purpose, the initiative shows similarities with the PRIIPR that applies to ‘PRIIP manufacturers’<sup>248</sup> and to ‘persons advising on or selling PRIIPs’.<sup>249</sup> The PEPP initiative, thus, focuses on regulating the PEPP provider and distributor.

### **5.2.1. PEPP Provider**

PEPPs are characterized by a contract or agreement between an individual (consumer) and a provider (financial institution).<sup>250</sup> EIOPA has throughout the PEPP consultations considered two approaches to regulate PEPP providers.<sup>251</sup> EIOPA originally considered a stand-alone authorization regime<sup>252</sup> with specific conduct of business<sup>253</sup> and prudential requirements for PEPP providers to ensure a level-playing field.<sup>254</sup> The stand-alone regime was intended to allow not only ‘EEA PEPP providers’ but also PEPP providers not authorized under any EEA legislation to provide PEPPs. This would ensure that such providers would not fall in an authorization gap and that a level playing field would be ensured that would lead to higher consumer protection provided that those providers would fulfill an ‘equivalence assessment’

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<sup>246</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 25.

<sup>247</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 48.

<sup>248</sup> Recital 38, Art. 3, 4(4) PRIIPR.

<sup>249</sup> Art. 2(1) PRIIPR.

<sup>250</sup> European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 15.

<sup>251</sup> See European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 33, [https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf).

<sup>252</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 11-12.

<sup>253</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 11-12.

<sup>254</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 11-12.

ascertaining the comparability with providers under the EEA sectoral legislation.<sup>255</sup> The large majority of the stakeholders, however, responded that regulatory arbitrage should be prevented and that providers should only be allowed to enter the PEPP market that are authorized under existing EEA legislation.<sup>256</sup> Moreover, a separate authorization regime would lead to additional regulatory burden that would discourage EEA financial intermediaries from becoming PEPP providers, because of the cost implications.<sup>257</sup> For this reason, EIOPA changed its view and came to the conclusion that current sectoral authorization regimes should be used and that the provision of PEPP should be limited to those providers authorized under relevant European legislation.<sup>258</sup> The sectoral-approach, however, has as a consequence that only those PEPPs may be offered for which the provider is authorized according to the current legislation for the respective sector.

#### 5.2.1.1. The Joint Principles of EEA Intermediary Regulation

The PEPP initiative in this regard should be seen as a ‘patch-up legislation’ that keeps the regulatory burden for PEPP providers to a minimum.<sup>259</sup> The approach to allow PEPP providers to be offering PEPPs on the basis of current sectoral legislation is justified as financial intermediaries regulated on the EEA level show remarkable cross-sectoral consistencies in the way how they are regulated.<sup>260</sup> This is, in particular, to be seen in the common authorization and organizational requirements to be observed throughout Solvency II, CRD IV, the AIFMD and UCITS V.

Credit institutions, AIFMs, UCITS ManCos and insurance undertakings have to comply with general (authorization and) organizational requirements that are common to financial

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<sup>255</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 12.

<sup>256</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>257</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 33,

[https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf);

European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>258</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>259</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>260</sup> D.A. Zetsche, *The AIFMD and the Joint Principles of European Asset Management Law* (D. Zetsche ed, Kluwer 2015), 865.

intermediaries in European financial law and specific requirements aimed at the provision of financial services/activities and products.<sup>261</sup>

General organizational requirements require the establishment of an organizational structure that clearly assigns responsibilities, employ personnel with the rights skills, knowledge and experience, establish adequate systems to safeguarding information and ensure business continuity.<sup>262</sup> General organizational requirements include:<sup>263</sup>

- fit & proper senior management;
- minimum capital requirements that vary upon the type of financial service/product provided;
- a business plan;
- adequate risk organization;
- sound third-country relationships; and
- reliable significant shareholders.

Specific organizational requirements that complement the general requirements. These include compliance, risk management internal audit, complaints handling, personal transactions, delegation/outourcing and the appointment of a depositary/the safeguarding of client assets.<sup>264</sup>

The reason is that all financial intermediaries in the EEA have common objectives: (1) investor/consumer protection (2) market protection (systematic risks) and (3) stakeholder protection. By requiring certain common organizational and operational requirements upon authorization, the EEA legislature ensures that only fit & proper financial intermediaries are active on the European markets that are required by sectoral legislation to be highly specialized in the financial services/products they are, with certain exceptions in the asset management domain<sup>265</sup>, offering.<sup>266</sup>

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<sup>261</sup> D.A. Zetsche, *The AIFMD and the Joint Principles of European Asset Management Law* (D. Zetsche ed, Kluwer 2015), 865; International Organisation of Pension Supervisors, *Managing and Supervising Risks in DC Pension Plans*, <http://www.iopsweb.org/dataoecd/48/1/46126017.pdf> (accessed 14 January 2017).

<sup>262</sup> European Commission, *Background Note accompanying Draft Commission Directive implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive*, February 2006, 6 et seq.

<sup>263</sup> D.A. Zetsche, *The AIFMD and the Joint Principles of European Asset Management Law* (D. Zetsche ed, Kluwer 2015), 865.

<sup>264</sup> C.M. Grundmann-van de Krol, *The Markets in Financial Instruments Directive and Asset Management* (D. Busch & D.A. DeMott eds, Oxford 2012).

<sup>265</sup> UCITS ManCos and AIFMs are allowed to discretionary manage IORPs and individual portfolio's under the AIFMD and UCITSD V. Nevertheless, MiFID II, AIFMD and UCITSD V all regulate the core business of 'investment management'. See Another exception are credit institutions that are 'automatically' recognized as investment firms under MiFID II. See Art. 1(3) MiFID II and Annex 1 CRD IV.

<sup>266</sup> A legal entity that obtained an authorization as UCITS ManCo is, for example, for that reason prohibited from obtaining a license as an insurance undertaking. See Commission of the European Communities, *Toward a European Market for the Undertakings for Collective Investment in Transferable Securities – Commentary on the*



Financial intermediaries do, however, provide different types of financial/services and products with different risk profiles. This is, in particular, highlighted in operating conditions in which some requirements are common throughout sectoral EEA legislation, but the main part of the conditions are business specific.

Sectoral EEA legislation, for instance, imposes a duty of loyalty on all EEA financial intermediaries. Financial intermediaries, when providing financial services/products to consumers, have to act honestly, fairly and professionally in accordance with the best interests of its consumers and comply with information duties to consumers.<sup>267</sup> This ‘open standard’<sup>268</sup> is specified in an investor protection regime that specifies a number of fiduciary obligations and information requirements towards consumers.

For AIFMs, UCITS ManCos and insurance undertakings, the operating conditions, however, also diverge on the basis of the risks that are born by different types of investors. For this purpose, various conduct of business obligations distinguish between the provisions applying to retail consumers and professional consumers.<sup>269</sup>

Financial intermediaries do provide different types of financial/services and products with different risk profiles. This is highlighted in different operating conditions, for example, in the solvency rules that applies to them. Credit institutions, (re)insurance undertakings take principal risk<sup>270</sup> and are, therefore, subjected to capital requirements that underlie the ordinary contractual claims of consumers towards them. To the contrary, AIFMs/UCITS ManCos act as a mere service intermediary providing investment management, risk management, administration and marketing service to their customers. In this capacity, they act as a service intermediary and do not take principal risk themselves. Instead, the investors fully bear the investment risks of the AIFs/UCITS in which they are invested.

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*provisions of Council Directive 85/611/EEC of 20 December 1985* (‘Vandamme Report’), 3, <http://goo.gl/K0iUzv> (accessed 14 January 2017).

<sup>267</sup> Art. 24(1) MiFID II.

<sup>268</sup> M. Kruithof, *Conflicts of Interest in Institutional Asset Management: Is the EU Regulatory Approach Adequate?*, 31, <http://ssrn.com/abstract=871178> (accessed 14 January 2017); L. Enriques, *Conflicts of Interest in Investment Services: The Price and Uncertain Impact of MiFID’s Regulatory Framework* (G. Ferrarini & E. Wymeersch eds., Oxford University Press 2006); A. Crockett, T. Harris, F.S. Mishkin & E.N. White, *Conflicts of Interest in the Financial Services Industry: What Should We Do About Them?*, 5 Geneva Reports on the World Economy (2003).

<sup>269</sup> See, for instance, for retail AIFs: Art. 43 AIFMD. See for the implementation of this provision: D.A. Zetzsche, *Fondsregulierung im Umbruch - ein rechtsvergleichender Rundblick zur Umsetzung der AIFM-Richtlinie*, 1 ZBB 32 (2014).

<sup>270</sup> See on principle risk: S.L. Schwarcz, *Intermediary Risk in a Global Economy*, 6 Duke Law Journal 1541 (2001).

For this reason, EIOPA now pursues a sectoral-approach in which, for example, they do not find it proportionate to design one solvency regime that fits all possible PEPP providers and characteristics of possible PEPP providers.<sup>271</sup> Instead, the type of underlying third-pillar products of PEPP provided is proposed to be limited to those providers authorized under sectoral EEA legislation.<sup>272</sup>

#### 5.2.1.2. PEPP Providers – A Proposal for a Sectoral Approach

The joint principles of EEA intermediary regulation allows EEA regulated intermediaries that already offer third-pillar retirement products to be eligible as a PEPP provider. The authorization includes a European (Intermediary) passport under which the PEPP initiative would allow EEA intermediaries to be active on a cross-border basis. For the provision of a PEPP, PEPP providers may only offer those PEPPs that contain an underlying third-pillar retirement product for which they are authorized under EEA sectoral legislation.<sup>273</sup> Consequently, the authorization of a PEPP provider limits the range of PEPPs that may be offered to consumers in the accumulation phase, as well as, the payout solution in the decumulation phase. The intermediary regulation to which a PEPP provider is subjected and the eligible third-pillar retirement product (PEPP product regulation) are, thus, communicating vessels. The term ‘PEPP provider’ would, thus, need to be defined based upon this approach.

The nature and type of the products and providers seem to be the same as under the PRIIPR. PRIIP manufacturers are also fund managers, (life) insurance undertakings and credit institutions.<sup>274</sup> The PEPP initiative could use the definition of ‘PRIIP manufacturer’ under the PRIIPR as a basis for defining the PEPP provider.<sup>275</sup> A PRIIP manufacturer under Article 4(4) PRIIPR is either ‘any entity that manufactures PRIIPs’ or ‘any entity that makes changes to an

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<sup>271</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 9.

<sup>272</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>273</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>274</sup> Recital 12 PRIIPR.

<sup>275</sup> MiFID II and the IDD also define ‘manufacturers’. Under MiFID II, investment firms that ‘create, develop, issue and/or design in-vestment products’ should be considered as ‘manufacturers’. See European Securities and Markets Authority, *Final Report – ESMA’s Technical Advice to the Commission on MiFID II and MiFIR*, 19 December 2014, ESMA/2014/1569, 51, [https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569\\_final\\_report\\_\\_esmas\\_technical\\_advice\\_to\\_the\\_commission\\_on\\_mifid\\_ii\\_and\\_mifir.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569_final_report__esmas_technical_advice_to_the_commission_on_mifid_ii_and_mifir.pdf) (accessed 12 April 2017); Under Art. 25(1) IDD ‘manufacturers’ are insurance undertakings and intermediaries who ‘manufacture’ products. Following Recital 33 IDD this means the ‘design’ of products by intermediaries for a group of – potential- clients, setting/proposing coverage requirements, limits of indemnity, exclusions, etc; These definitions, however, are sector-specific and the definition under the PRIIPR is cross-sectoral and covers almost all PEPP products and providers.

*existing PRIIP including, but not limited to, altering its risk and reward profile or the costs associated with an investment in a PRIIP*'. The term 'PRIIP' could be replaced by 'PEPP'. The meaning of 'manufacturing' is not further defined by the PRIIPR. EIOPA considers that PEPP providers and intermediaries should focus 'primarily on the design phase of the product'.<sup>276</sup>

A PEPP provider could, thus, be defined as

'an EEA financial intermediary that manufactures PEPPs or any EEA financial intermediary that makes changes to an existing PEPP including, but not limited to, altering its risk and reward profile or the costs associated with an investment in a PEPP'.

EEA financial intermediaries would be restricted to:

- Credit institutions authorized under CRD IV;
- AIFMs authorized under the AIFMD;
- UCITS ManCos authorized under UCITSD V; and
- Insurance undertakings authorized under Solvency II.
- MiFID II firms (see 5.2.2)

The sectoral approach under a future PEPP initiative would imply that EEA intermediaries may only offer those PEPPs that include the eligible third-pillar product for which they are authorized. This would lead to the following limitations:

- Credit institutions would be restricted to offering deposit-based PEPPs;
- AIFMs and UCITS ManCos, depending upon their types of authorization, to AIFs and UCITS and (full DC) IORPs;<sup>277</sup>
- Insurance undertakings to insurance products under Solvency II and (DC, hybrid and DB) IORPs.

Under the proposed PEPP initiative, the Report proposes to include only externally managed IORPs.<sup>278</sup> IORPs under the IORPD are allowed to have external or internal governing boards. Internal governing boards include the product and the intermediary<sup>279</sup>, whereas external governing boards are governing boards in which the IORP as product and the governing board as financial intermediary are separated. This differentiation primarily depends upon the legal form and the type of IORP (insurance, investment fund or pension fund nature) available under national law. The main problem with internally managed IORPs is that their governing boards are, to a limited extent, regulated under European law. In addition, IORP governing boards are

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<sup>276</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 36.

<sup>277</sup> See. D.A. Zetsche & D. Eckner, *Appointment, Authorization and Organization of the AIFM* (D. Zetsche ed, Kluwer 2015); Cf. Organisation for Economic Co-operation and Development, *Guidelines on Pension Fund Asset Management*, <http://www.oecd.org/dataoecd/59/53/36316399> (access 21 December 2016)

<sup>278</sup> Referred to as 'pensioenuitvoerder'. See Art. 1 Pension Act.

<sup>279</sup> See, for instance, in the Netherlands: Art. 1 Pension Act.

boards that are fit & proper in administering second-pillar pension products, whereas the PEPP initiative is a third-pillar pension products for which there is no mandatory participation duty and, thus, a commercial aspect. It would be recommendable to only allow ‘external IORP boards’ comprising of EEA regulated intermediaries that, besides IORPs, also run third-pillar pension products and not those IORP boards merely regulated on the national level.<sup>280</sup>

Under the proposed PEPP definition, PEPP providers may also be ‘any EEA financial intermediary that makes changes to an existing PEPP including, but not limited to, altering its risk and reward profile or the costs associated with an investment in a PEPP’. In this regard, it is important to note that PEPP providers not being authorized to offer guarantees or underwriting biometric risks would need to be prohibited from doing so, unless they enter into a partnership with those providers that are being authorized to do so.<sup>281</sup>

A UCITS ManCo offering, for example, a UCITS-based PEPP would be prohibited from underwriting biometric risks without the involvement of an insurance undertaking covering those biometric risks whether this is in the accumulation or in the payout phase. In the accumulation phase, this could be done by a UCITS ManCo concluding a contracting with an insurance undertaking covering these biometric risks. These risks would have to be borne by consumers themselves for those PEPP providers that offer PEPPs other than PEPPs based upon insurance products or IORPs. IORPs take a special position as some are full DC, whereas others cover biometric risks. IORP-based PEPPs would be allowed to be provided by AIFMs, UCITS ManCos or insurance companies if the biometric risks are covered by the IORP itself under the IORPD.

Credit institutions, UCITS ManCos and AIFMs would be allowed to offer payout solutions that include lump sums and phased drawdown plans.<sup>282</sup> Insurance undertakings, apart from these

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<sup>280</sup> In Spain and Portugal, IORPs are set up in the contractual form and financial intermediaries are the external governing body. In both Portugal and Spain the governing body can be an insurance undertaking or a pension fund management company that is authorized under national law and whose sole purpose is the management of the IORP. Spain: Art. 20 Real Decreto Legislativo 1/2002, de 29 de noviembre, por el que se aprueba el texto refundido de la Ley de Regulación de los Planes y Fondos de Pensiones and Art. 4 Real Decreto 304/2004, de 20 de febrero, por el que se aprueba el Reglamento de planes y fondos de pensiones; Portugal: Art. 32, 38 Decreto-Lei n.º 12/2006 de 20 de Janeiro; See also : J. Yermo & A. Marossy, *Pension Fund Governance*, Insurance and Private Pensions Compendium for Emerging Economies Book 2 Part 1:4)b, [www.oecd.org/finance/private-pensions/1815934.pdf](http://www.oecd.org/finance/private-pensions/1815934.pdf) (accessed 14 January 2017), 10.

<sup>281</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 9.

<sup>282</sup> P. Antolin, C. Pugh, & F. Stewart, *Forms of Benefit Payment at Retirement*, OECD Working Papers on Insurance and Private Pensions No. 26 (2008) <http://www.oecd.org/dataoecd/39/4/41408028.pdf> (accessed 14 January 2017).

solutions, would be allowed to offer annuities and integrated payout products combining characteristics of annuities and drawdown plans as well.<sup>283</sup>

Consumers of credit institutions, UCITS ManCos and AIFMs offering PEPPs not covering biometric risks may in the payout phase opt to for a lump sum, i.e. a one-time payment for the total value of the accumulated PEPP capital, and buy an annuity offered by an insurance undertaking.<sup>284</sup>

Depending upon the preferences of the PEPP provider, PEPP providers may opt to be merely a 'manufacturer' or a distributor as well in the sale stage.<sup>285</sup>

### 5.2.2 Distributor

EIOPA considered in its final advice that distributors are a source of information on the market that help consumers in accessing products, assisting consumers in their product choice and help consumers with investment allocations within a PEPP and switching investment options.<sup>286</sup> The regulatory framework of distribution channels is, thus, a key factor in determining the success of a PEPP regulatory framework.

Before a proposed distribution regime that includes a sectoral approach based upon the IDD, MiFID II and DMD will be proposed, various considerations on distribution rules for PEPP distributors will be made. This section continues in addressing the IDD and MiFID II product governance and oversight rules and the implications of the proposed PEPP distribution regime for the financial industry. This section concludes by some considerations on the inconsistencies under the IDD and MiFID II distribution regimes.

#### 5.2.2.1. Considerations on a PEPP Distribution Regime

Regulatory differences at distribution level may impact the well-functioning of a PEPP product passport. For this reason, various policy options have been considered in the industry.<sup>287</sup>

The first option was to implement a harmonized distribution regime for all PEPP distributors either based upon the IDD, MiFID II distribution regimes or a new set of distribution rules for

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<sup>283</sup> See for an overview of payout solutions: European Fund and Asset Management Association, *Towards a Single Market for European Personal Pensions: Building Blocks for an EU legislation*, March 2015, 30, 31, [https://www.efama.org/Publications/Public/EFAMA%20\\_EPP\\_Report\\_FINAL4March2015%29.pdf](https://www.efama.org/Publications/Public/EFAMA%20_EPP_Report_FINAL4March2015%29.pdf) (accessed 14 January 2017).

<sup>284</sup> P. Antolin, C. Pugh, & F. Stewart, *Forms of Benefit Payment at Retirement*, OECD Working Papers on Insurance and Private Pensions No. 26 (2008) <http://www.oecd.org/dataoecd/39/4/41408028.pdf> (accessed 14 January 2017).

<sup>285</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 36.

<sup>286</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457.

<sup>287</sup> European Fund and Asset Management Association, *Working Note on possible distribution rules for the PEPP*, 13 February 2017 (on file with the authors).

PEPP distributors. The problem is that the IDD is based upon minimum harmonization and less stringent than the MiFID II distribution regime. Introducing an IDD based regime would imply that all PEPPs are considered to be insurance products. Allowing AIFMs/UCITS ManCo to distribute non-insurance PEPPs on the basis of an IDD regime would lead to sectoral inconsistencies with the AIF/UCITS sectoral marketing regimes under MiFID II. At the other hand, considering all PEPPs to fall within the scope of MiFID II would make the distribution of PEPPs that are based upon insurance products more stringent, which might potentially lead to objections from the insurance industry in the PEPP negotiation process. The adoption of a new distribution regime would be cumbersome and would need the approval of Member States. These options could lead to disagreements and delay the adoption of a future PEPP initiative. The second option would be to leave the distribution up to the local distribution rules in the individual Member States. The negative experiences with local marketing rules impeding the UCITS marketing passport under UCITSD I-III renders this option unlikely. Not until the adoption of UCITSD IV were the problems related to the UCITS notification procedure resolved, leaving this option as unrealistic.<sup>288</sup> Finally, the last option would opt for a sectoral-based approach that applies the IDD, MiFID II and DMD based upon the nature of the PEPP that is being marketed. This option is preferable as it leads to no additional costs of implementing new marketing regimes and will now be discussed more in detail.

#### 5.2.2.2. Proposed Distribution Regime: IDD, MiFID II & DMD

Distributors can be part of the PEPP provider, an agent of a PEPP provider or a third party.<sup>289</sup> The purpose of distribution rules is that distributors give appropriate information and advice to PEPP holders to ensure that conflicts of interest are not to the detriment of the consumer.<sup>290</sup> Within the context of the PRIIPR, a distributor could be defined under the PEPP initiative as ‘a person advising on, or selling<sup>291</sup>, PEPPs’.<sup>292</sup> This definition would capture AIFMs and UCITS ManCos as PEPP providers that are under the AIFMD and UCITSD V authorized to market

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<sup>288</sup> European Commission, *White Paper of 15 November 2006 (COM (2006) 686 final) on enhancing the single market framework for investment funds*, [http://ec.europa.eu/internal\\_market/securities/docs/ucits/whitepaper/whitepaper\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/ucits/whitepaper/whitepaper_en.pdf) (accessed 14 January 2017); European Commission, *Commission Staff Working Document of 12 July 2005 (SEC(2005) 947) - Annex to the Green Paper on the enhancement of the EU Framework for Investment Funds*, [http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background\\_en.pdf](http://ec.europa.eu/finance/investment/docs/consultations/greenpaper-background_en.pdf) (accessed 14 January 2017).

<sup>289</sup> International Organisation of Securities Commissions, *Investment Management Risk Assessment: Marketing and Selling Practices*, <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD156.pdf> (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 40.

<sup>290</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 28.

<sup>291</sup> Selling could be defined as ‘a person offering or concluding a PEPP contract to a customer’. See for a similar definition under Art. 4(5) PRIIPR: ‘person selling a PRIIP’ means a person offering or concluding a PRIIP contract with a retail investor’.

<sup>292</sup> Recital 38 Art. 2(1) PRIIPR.

AIF/UCITS units to consumers. In addition, this definition would also include investment firms/credit institutions under MiFID II and insurance companies/undertakings under the IDD. The advantage of the proposed definition is that both PEPP providers and distributors would in their capacity of distributor have a European passport under the respective European legislative acts.<sup>293</sup>

EIOPA highlights that the requirements set out in the IDD, MiFID II and DMD for IBIPs<sup>294</sup> and financial instruments are of particular relevance.<sup>295</sup> A considerable part of investment and insurance products are currently already governed by these two pieces of EEA legislation.<sup>296</sup> The IDD and MiFID II currently, however, exclude ‘pension products which, under national law, are recognised as having the primary purpose of providing the investor with an income in retirement, and which entitle the investor to certain benefits’.<sup>297</sup> Although these exemptions refer to ‘pension products under national law’, these exemptions under MiFID II and the IDD would need to be removed for the ‘European pension product’ PEPP. This would need to be done in order to establish a level playing field between the investment and insurance products under sectoral legislation and PEPPs that are merely a ‘wrapper’ of these products with a retirement objective. Extending the IDD and the MiFID II to PEPPs also leads to consistency between the distribution of PEPPs that are insurance and non-insurance based. The recently adopted IDD is inspired by MiFID II and distribution is regulated under both legislative acts upon the same principles targeting different financial intermediaries and products.

The IDD establishes sales requirements for insurance products sold by both insurance undertakings (providers) and intermediaries (distributors).<sup>298</sup> The provisions laid down in the IDD focus on the provision of advice to the customer. The customer needs to be informed on the basis on which the advice is provided.

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<sup>293</sup> Cf. Art. 4(5) PRIIPR: ‘person selling a PRIIP’ means a person offering or concluding a PRIIP contract with a retail investor’.

<sup>294</sup> An ‘insurance-based investment product’ under Art. 4(2) PRIIPR means ‘an insurance product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations’.

<sup>295</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 44.

<sup>296</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 43.

<sup>297</sup> Art. 2(1) Nr. 17(c) IDD.

<sup>298</sup> European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products*, 7, [http://ec.europa.eu/dgs/health\\_food-safety/dgs\\_consultations/ca/docs/swd\\_consumer\\_protection\\_thirds\\_pillar\\_pensions\\_en.pdf](http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf) (Accessed 14 January 2017).



MiFID II applies to PEPPs when financial instruments are involved.<sup>299</sup> The overarching concept of both the IDD and MiFID II is that distributors selling financial instruments and IBIPs are advising customers on those PEPPs that a client understands and that meets the client's objectives (suitability and appropriateness).<sup>300</sup>

Both MiFID II and the IDD differentiate between advised and non-advised distribution. The strong standardized<sup>301</sup> and 'non-complex'<sup>302</sup> nature of the 'default investment option' under the PEPP initiative does not require the application of the appropriateness requirements that apply to complex financial instruments and IBIPs under MiFID II and the IDD.<sup>303</sup> The 'default investment option' would, therefore, in the view of EIOPA be perfectly suitable for online distribution to benefit from cost savings.<sup>304</sup> EIOPA also does not consider for the default investment option mandatory advice regime to be appropriate in the PEPP context with simple and standardized products.<sup>305</sup>

Non-advised PEPPs that are distributed online are regulated by the DMD the distance marketing of consumer financial services that lays down fundamental rights for consumer.<sup>306</sup>

The proposed definition of 'distribution' would, thus, allow both PEPP providers and distributors under the IDD and MiFID II to market PEPPs based upon existing European passport arrangements under current sectoral EEA legislation.

### 5.2.2.3. Overarching Governance Standard: Product Governance and Oversight

Extending the IDD and MiFID II to PEPPs would imply that product oversight and governance requirements under these acts would apply to PEPPs.<sup>307</sup> Under this approach, both product

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<sup>299</sup> European Commission, *Commission Staff Working Document of 11 April 2013: Consumer protection in third-pillar retirement products*, 9, [http://ec.europa.eu/dgs/health\\_food-safety/dgs\\_consultations/ca/docs/swd\\_consumer\\_protection\\_thirds\\_pillar\\_pensions\\_en.pdf](http://ec.europa.eu/dgs/health_food-safety/dgs_consultations/ca/docs/swd_consumer_protection_thirds_pillar_pensions_en.pdf) (Accessed 14 January 2017).

<sup>300</sup> European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 84.

<sup>301</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 34.

<sup>302</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 42.

<sup>303</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 42.

<sup>304</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 10.

<sup>305</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 10.

<sup>306</sup> EIOPA, Consultation on the creation of a standardised Pan-European Personal Pension product (PEPP), EIOPA-CP-15/006, 03.07.2015, p. 35. Cf. Recital 12 and Art. 23(2) IDD.

<sup>307</sup> Joint Committee, Joint Position of the European Supervisory Authorities on Manufacturers' Product Oversight &

manufacturers that manufacture and distribute PEPPs and distributors that merely distribute products that are manufactured by other providers would be targeted.<sup>308</sup>

The PEPP initiative departs from the point that consumers regard financial products are too complex and that disclosure does not, on its own, allow consumers to make better investment decisions due to cognitive and behavioral biases.<sup>309</sup> Extending the IDD and MiFID II product governance requirements to PEPPs would require PEPP providers and distributors to take measures prior to a PEPP launch on the market and during the lifecycle of the PEPP.<sup>310</sup> To achieve a ‘consumer-centric approach’, both providers and distributors are required to identify a target market to ensure consumer protection in the product development process.<sup>311</sup> Needs of the target market including the risks of the product and risk appetite of those consumers, demographic factors, financial capability and demographic factors, need to be taken into account in the product designing process. Product oversight and governance requirements have to be also operative throughout the product life cycle to allow for monitoring and review and to ensure that misalignments can be rectified.<sup>312</sup> These ongoing measures to be undertaken are, amongst others, stress testing of the product, the selection of appropriate distribution channels and monitoring that the product is being sold to the right target market.<sup>313</sup> By extending the

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GovernanceProcesses, [https://eiopa.europa.eu/Publications/Administrative/JC\\_2013\\_77\\_POG\\_Joint\\_Position\\_.pdf](https://eiopa.europa.eu/Publications/Administrative/JC_2013_77_POG_Joint_Position_.pdf) (accessed 14 January 2017).

<sup>308</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 48; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 48.

<sup>309</sup> W. Tapia & J. Yermo, *Implications of Behavioural Economics for Mandatory Individual Account Pension Systems*, <http://www.oecd.org/dataoecd/5/22/39368306.pdf> (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 46.

<sup>310</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 46.

<sup>311</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 23; Cf. Organisation for Economic Co-operation and Development, *Guidelines for the Protection of Rights of Members and Beneficiaries in Occupation Pension Plans*, <http://www.oecd.org/dataoecd/16/33/34018295.pdf> (access 21 December 2016).

<sup>312</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 48; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 48.

<sup>313</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 48; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 47.

IDD and MiFID II to PEPPs, the PEPP initiative would introduce product governance requirements on the provider and distribution level that would avoid mismatches between how PEPPs should be used and how they are actually used by consumers.<sup>314</sup>

#### 5.2.2.4. Implications of the Proposed PEPP Distribution Regime for the Financial

##### Industry

Introducing the proposed PEPP ‘distributor regime’ would allow both PEPP providers and ‘independent distributors’ to market PEPPs to consumers. Vesting the ‘PEPP distribution regime’ on PEPP providers and distributors that are already currently enjoying a European passport for distributing third-pillar pension products on a sectoral-basis ensures that considerable economies of scale can be achieved.<sup>315</sup> Also the EEA PEPP provider and product rules creates a level-playing field for all PEPP providers and distributors, thus, increasing competition, innovation and lower costs.

The PEPP distribution regime encourages credit institutions/investment firms, insurance undertakings/intermediaries, asset managers (UCITS ManCos and AIFMs) to expand their product offering. Distribution could take place under the integrative model and a stand-alone model. Under the integrative distribution model PEPP providers would also offer distribution services, whereas under the stand-alone model, distribution is being outsourced to a specialized distributor.

PEPPs could therefore be (but is not limited to) a ‘mass-market’ retail product. From this perspective, credit institutions and investment firms as specialized distributors could offer services, including advice on investment and payout options, tax implications and retirement planning.

Both insurance undertakings as PEPP provider and intermediaries as specialized distributor could offer PEPPs based upon life insurances and unit-linked policies as investment options under a PEPP.<sup>316</sup> Insurance undertakings as PEPP providers under the integrative model have a competitive advantage over UCITS ManCos and AIFMs. They are under the PEPP provider proposal in the OCERP report able to both manufacture and distribute PEPPs that provide coverage of biometric risks in the accumulation and payout phase, such as annuities. It is,

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<sup>314</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 47; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 46.

<sup>315</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 40, [https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf).

<sup>316</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 40, [https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf).

nevertheless, highly likely that insurance undertakings would cooperate with credit institutions and, in particular, UCITS ManCos/AIFMs, that would help them in manufacturing the underlying third-pillar pension product in offering investment options that include insurance elements.<sup>317</sup>

UCITS ManCos and AIFMs are under UCITSD V and the AIFMD allowed to distribute UCITS and AIFMs to investors. Under the PEPP initiative, they would, however, primarily play a role as ‘manufacturing’ UCITS/retail AIFs as underlying investment products and managing the investment options. The reason for this is that many of them do not have the organizational capacity to distribute PEPPs directly to consumers.

#### 5.2.2.5. Considerations on the Convergence of future IDD & MiFID II Distribution Regimes

Both MiFID II and the IDD provide for distribution regimes that are similar but not identical.<sup>318</sup> The EEA sectoral legislation approach in adopting financial legislation has led to vertical harmonization, i.e. the harmonization of financial regulation within one sector. Nevertheless, horizontal harmonization, i.e. the harmonization of financial regulation throughout financial sectors is still an ongoing process. One clear example of this are the distribution regimes under MiFID II and IDD.

The MiFID I distribution regime was limited in scope and, therefore, mutual fund were often repackaged as unit-linked insurance or structured deposits.<sup>319</sup> As a result, Member States goldplated MiFID I in their national implementations by extending the MiFID I distribution regime to certain insurance products and structured deposits or including similar rules in their insurance laws.<sup>320</sup>

Upon adopting MiFID II and the IDD, awareness arose that a level playing field for IBIPs would need to be established that was not in place under MiFID I and the IMD. Although the IDD has made an important step, there are still differences to be observed between the IDD that aims at minimum harmonization and the MiFID II that aims at maximum harmonization.<sup>321</sup> For example, the MiFID II inducements regime is much stricter than its IDD counterpart.<sup>322</sup>

The case could be made to develop a coherent cross-sectoral piece of distribution legislation related to insurance and non-insurance products that would also affect a future PEPP initiative.

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<sup>317</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 41,

[https://www.efama.org/Publications/Public/EFAMA\\_OCERP\\_Report\\_September\\_2013\\_Print\\_Final.pdf](https://www.efama.org/Publications/Public/EFAMA_OCERP_Report_September_2013_Print_Final.pdf).

<sup>318</sup> V. Colaert, *MiFID II in Relation to Other Investor Protection Regulation: Picking Up the Crumbs of a Piecemeal Approach*, 3 <https://ssrn.com/abstract=2942688> (accessed 14 January 2017).

<sup>319</sup> N. Moloney, *EU Securities Regulation* 780 (3<sup>rd</sup> edn., Oxford University Press 2014).

<sup>320</sup> See V. Colaert, *Building Blocks of Investor Protection: All-Embracing Regulation Tightens Its Grip*, <https://ssrn.com/abstract=2942688> (accessed 14 January 2017).

<sup>321</sup> See for an extensive observation of the similarities and differences of the MiFID II and IDD distribution regime: V. Colaert, *MiFID II in Relation to Other Investor Protection Regulation: Picking Up the Crumbs of a Piecemeal Approach*, <https://ssrn.com/abstract=2942688> (accessed 14 January 2017).

<sup>322</sup> Art. 29(2) IDD; See also Art. 24(7) MiFID II.

To that end, the stricter MiFID II standards could be extended to IBIPs as they are perceived by the consumer to be substitutes.<sup>323</sup> This is highlighted by the ‘wrapper nature’ of the PEPP. The PEPP initiative could be a starting point to reconsider the inconsistencies between the distribution regimes under the IDD and MiFID II. The IDD and MiFID II inconsistencies should, however, be addressed in the light of a future coherent cross-sectoral piece of distribution legislation that would reconsider the investor protection needs and relevant conduct of business rules applying to both investment and insurance products.

### 5.2.3 Depositary/Custodian

EIOPA has suggested in its advice<sup>324</sup> that for the depositary as a governance requirement related to the provider should be further explored in the context of PEPPs.<sup>325</sup> EIOPA has suggested in its advice<sup>326</sup> that for the use of depositaries the sector-specific requirements on the use of depositaries would to the best reflect the PEPP provider’s characteristics and business model.<sup>327</sup>

The question arises whether and to what extent a depositary should be required to be appointed and what responsibilities a depositary for the purpose of the PEPP initiative should have.

For the purpose of its advice on depositaries, EIOPA considered products under the UCITSD V, AIFMD, Solvency II, CRD IV, and IORPD (II).

EIOPA sees depositaries as a ‘*specific organizational or governance measure for funds that relates to the legal form of the fund (as collective investments, where assets remain property of investors)*’.<sup>328</sup> The depositary is an important risk mitigation tool and mandatorily required under the AIFMD and UCITSD V.<sup>329</sup> The depositary in the separation of investment and management under these laws provides for asset partitioning and limited liability. The

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<sup>323</sup> V. Colaert, *MiFID II in Relation to Other Investor Protection Regulation: Picking Up the Crumbs of a Piecemeal Approach*, 27, <https://ssrn.com/abstract=2942688> (accessed 14 January 2017).

<sup>324</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 22.

<sup>325</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 15, 16.

<sup>326</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 22.

<sup>327</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 22; European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 22.

<sup>328</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 21.

<sup>329</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 21, 22.

safekeeping of the assets of an fund ensures that the assets of the investors are being administratively segregated from the assets of the AIFM/UCITS ManCo, the depositary itself and other investors. As a result, investors cannot be held liable for creditor claims other than the claims on the common fund property. Investors investing in AIFs and UCITS bear the full investment risk and, therefore, the depositary is exercising a number of controlling duties on top of the safekeeping function to overcome the agency problem gap left by the discretionary management of assets by the asset manager. The pooled risk undertaken by the collective investors does not only imply an agency relationship between the collective investors and the (collective) asset manager, but also amongst the investors itself. The control duties performed by the depositary on behalf of the joint investors is in line with the cheapest cost avoider theory and overcomes the free riding problem. Under the AIFMD and UCITSD V, a depositary, thus, reduces the risk of misappropriation and insolvency motivated by investors remaining the ‘owners’.<sup>330</sup>

For PEPPs that are based upon products under Solvency II and CRD IV/CRR no depositary is required to be appointed. Credit institutions, (re)insurance undertakings, unlike AIFMs/UCITS ManCos, take principal risk<sup>331</sup>, do not act as a mere service intermediary and are, therefore, subjected to capital requirements that underlie the ordinary contractual claims of consumers towards them. No depositary is required as misappropriation nor bankruptcy leads to a shift in the ranking of the ordinary contractual claims towards these intermediaries that take principal risk.

Regarding IORPs, the IORP trilogue discussions<sup>332</sup> did not produce a satisfactory outcome whether or not depositaries should be required to be appointed for full DC IORPs in which members bear full investment risk or to include also hybrid and DB IORPs in which conditional guarantees may be given and/or biometric risks may be covered.<sup>333</sup> The final version of IORPD II leaves the appointment of a depositary to the individual Member States with host Member States being able to demand a depositary for full DC IORPs.<sup>334</sup> The unsustainability of hybrid and DB IORPs in the post-crisis era giving an unconditional guarantee leaves members still bearing investment risks as misappropriation of investment

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<sup>330</sup> Depending upon the jurisdiction involved the legal title of the AIF/UCITS assets may be the AIFM/UCITS ManCo, depositary or, if having legal personality, the fund itself. D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012). ‘Ownership’, however, should be understood as having legal ownership or a contractual priority claim based upon regulatory law that resembles, to a large extent, legal ownership and ranks ahead of all other claims towards the fund property. See International Organisation of Securities Commissions, *Client Asset Protection*, Report of the IOSCO Technical Committee (August 1996), 13; S.N. Hooghiemstra, *De AIFM-richtlijn en de aansprakelijkheid van de bewaarder*, 6 TvFR 178 (2013).

<sup>331</sup> S.L. Schwarcz, *Intermediary Risk in a Global Economy*, 6 Duke Law Journal 1541 (2001).

<sup>332</sup> A. van den Brink & H. van Meerten, *EU Executive Rule-Making and the Second Directive on Institutions for Occupational Retirement Provision*, 12 UU Law Review 1

<sup>333</sup> See Art. 28 IORPD II

<sup>334</sup> Art. 35 IORPD II.



assets may lead to a lowering of original ‘guaranteed’ retirement income or the demand for higher contributions.<sup>335</sup>

If a sector-specific approach for the use of depositaries would be pursued then no considerations would have to be made whether or not a depositary should be required to be appointed for PEPPs as this issue is already solved at the level of the sector specific legislations. The sectoral approach also prevents a ‘double depositary requirement’ as this approach, for instance, would not require insurance undertakings acting as PEPP providers to appoint a depositary for life insurances offered. Underlying investment options that would include UCITS or (retail) AIFs, however, would require the appointment of a depositary.

Including a sector-specific requirement based on the underlying third-pillar pension product on the use of depositaries reflects, indeed, the business model of PEPPs the best.

### **5.3 Sales Regulation/Disclosure**

Sales regulation or disclosure of information plays a pivotal role in financial law in overcoming the information asymmetry gap between the financial services industry and consumers.<sup>336</sup> EIOPA conducted extensive research in considering appropriate disclosure of information for PEPPs.<sup>337</sup> In conducting its research, EIOPA took into account the specific needs of consumers during life cycle of a PEPP, i.e. the needs of consumers in the pre-contractual, ongoing or accumulation, pre-retirement and payout phase.<sup>338</sup>

#### **5.3.1. Pre-contractual information**

Pre-contractual information should enable consumers to decide whether to invest in a particular PEPP and also to decide over the one investment option over the other offered by the PEPP.<sup>339</sup>

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<sup>335</sup> Cf. A-G Opinion (15 March 2016), *Stichting Pensioenfonds*, ECLI: NL:PHR:2016:91, para. 7.15.

<sup>336</sup> W. Tapia & J. Yermo, *Implications of Behavioural Economics for Mandatory Individual Account Pension Systems*, <http://www.oecd.org/dataoecd/5/22/39368306.pdf> (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Report on Good practices on information provision for DC schemes*, 24 January 2013, EIOPA-BoS-13/010; European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 25; Organisation for Economic Co-operation and Development, *Improving Financial Education and Awareness on Insurance and Private Pensions*, [http://www.oecd-ilibrary.org/finance-and-investment/improving-financial-education-and-awareness-on-insurance-and-private-pensions\\_9789264046399-en](http://www.oecd-ilibrary.org/finance-and-investment/improving-financial-education-and-awareness-on-insurance-and-private-pensions_9789264046399-en) (access 21 December 2016).

<sup>337</sup> European Insurance and Occupational Pensions Authority, *Good practices on information provision for DC schemes Enabling occupational DC scheme members to plan for retirement*, 24 January 2013, EIOPA BoS 13/010; European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 29; A.I. Rinaldi & E. Giacomel, *Information for Members of DC Pension Plans: Conceptual Framework and International Trends*, <http://www.iopsweb.org/dataoecd/7/16/41269701.pdf> (accessed 14 January 2017).

<sup>338</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 25-33.

<sup>339</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 25.



Pre-contractual information must help consumers in understanding the features of individual PEPPs and to compare PEPPs.<sup>340</sup> EIOPA considers the PRIIPR to be a starting point for PEPP pre-contractual information.<sup>341</sup> This is as the PRIIPR currently covers IBIPs and other retirement products that may underlie a PEPP.

PEPPs currently fall outside the scope of PRIIPR and whether they will be included in the scope is subject to review in December 2018.<sup>342</sup> EIOPA, however, in this regard remarked that a PEPP pre-contractual disclosure regime should be adjusted in some respects from the general PRIIP in order to work for PEPPs.<sup>343</sup> Additional information considered to be needed include information related to investment choices by consumers to be made, options provided by national law, the provider on retirement and whether the PEPP can be inherited or not.<sup>344</sup> In addition, personalization of information is considered to be desirable, whereas this is not available for KIDs under the PRIIPR. For this purpose, EIOPA has made a proposal for a common basic structure for a KID based upon the PRIIPR that would be suitable for PEPPs.<sup>345</sup> EIOPA decided to include four more sections that relate to the switching between providers, whether the PEPP is inheritable, what happens if a consumer would stop investing and a section on investment choices.<sup>346</sup>

The PEPP initiative could be built upon the PRIIPR and include ‘patch-up provisions’ as to accommodate the PEPP to the need of the PEPP consumer. The general PRIIPR would be applicable but the scope, its application and content would then be amended by these ‘patch-up provisions’ laid down in the PEPP initiative itself. For practical purposes, EIOPA could provide an overview of all legislation applicable to KIDs to be provided to PEPP consumers by ‘copy-pasting’ all relevant PRIIPR sections and the applicable ‘patch-up provisions’ in a ‘soft law legislative instrument’ to not confuse the industry. Similarly, EIOPA could develop

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<sup>340</sup> European Commission, *Communication from the Commission on Package Retail Investment Products*, [http://ec.europa.eu/internal\\_market/finances-retail/docs/investment\\_products/29042009\\_impact\\_assessment\\_en.pdf](http://ec.europa.eu/internal_market/finances-retail/docs/investment_products/29042009_impact_assessment_en.pdf) (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 25.

<sup>341</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 30.

<sup>342</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 30.

<sup>343</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 31.

<sup>344</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 31.

<sup>345</sup> See European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 31-32.

<sup>346</sup> See European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 31-32.

technical standards as related to the ‘patch-up provision sections’ and, again, lay these standards down in a soft law legislative instruments, such as a communication.

### **5.3.2. Ongoing or Accumulation Phase**

The objective of information during the accumulation phase is to inform the consumer of the current status of the PEPP investments in retirement that takes into account costs, projected performance in the future and whether product features have changed.<sup>347</sup>

Although a PEPP KIID also contains relevant information for the accumulation phase, EIOPA considers in this regard the Pensions Benefit Statement (PBS) introduced under IORPD II to be providing additional appropriate annual information that should be given to consumers.<sup>348</sup> This annual statement, in particular, gives information about risks and return, costs, investment choices and decumulation.<sup>349</sup>

### **5.3.3. Pre-retirement information and Payout Phase**

Information disclosure requirements in the pre-retirement phase differ substantially from the requirements in the pre-contractual and accumulation stages.<sup>350</sup> Essentially, consumers would need to be informed about the start of the decumulation phase and what decumulation options can be chosen in both phases.<sup>351</sup> Regarding the latter, individual Member States would have key considerations to make regarding the disclosure that informs consumers about pay-out options available, how consumers may obtain quotations for payout options from providers, the acts to be taken, the default options applying if no action is taken, the impact of the option on inheritance and links to further guidance and independent financial advice.<sup>352</sup>

Member States are likely to orientate themselves on the ‘other information and documents’ that are to be provided under Chapter 3 IORPD. Article 57 IORPD II, for example, sets out information that should be given to beneficiaries of IORPs during the pay-out phase and Article 58 IORPD II on request to members and beneficiaries.

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<sup>347</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 30.

<sup>348</sup> Art. 40 and 40a IORPD II.

<sup>349</sup> Cf. European Insurance and Occupational Pensions Authority, *Good practices on information provision for DC schemes Enabling occupational DC scheme members to plan for retirement*, 24 January 2013, EIOPA BoS 13/010; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 37; European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 30-31.

<sup>350</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 32.

<sup>351</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 32.

<sup>352</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 33.

## **5.4 Position Consumers**

### **5.4.1 Exit, voice & loyalty**

PEPPs are characterized by the objective of investing with a pension retirement objective with a high range of different investment risks. PEPPs may provide guarantees, cover biometric risks or let consumers fully bear investment risks. ‘Consumer’ could be defined by adopting the ‘retail investor’ definition from Article 4(6) PRIIPR. Consumers would then be defined as ‘MiFID II retail clients or customers under the IDD that are not a professional client’. ‘Professional clients’ would then include *per se* professional clients and professional clients on request under MiFID II.<sup>353</sup> Unlike other (European) legal frameworks, PEPP does not differentiate between different types of ‘consumers’ based upon financial knowledge and capacity.<sup>354</sup> The PEPP product is designed for any type of consumer (the general public)<sup>355</sup> to save until retirement.<sup>356</sup>

The retail and long-term investment nature demands that consumers are enabled to assess their PEPP on a continuous basis.<sup>357</sup> The built-in option of switching providers and transfer of funds allows customers to switch between PEPPs and PEPP providers. The PEPP initiative allows (cost-free) switching periods that caters for an *exit* either by switching to another investment strategy with the same PEPP provider or the withdrawal and transfer of funds to a PEPP offered by another PEPP provider. The PEPP initiative, thus, focusses on the exit as primary consumer protection tool. The strong exit rights explains why consumers do have limited *voice*. They do not have voting rights or other legal rights to propose for change. Upon concluding the PEPP contract they are limited by picking amongst a limited number of investment options that are manufactured by the PEPP provider and underlie intermediary (PEPP provider, distributor), product and sales regulation. The retirement objective prevents consumers from exiting all PEPP investments. The objective of saving until retirement requires consumers to remain invested in a PEPP either offered by their own or another provider. Consumers, thus, have strong exit rights that are limited by switching providers and the transfer of funds.

### **5.4.2 Legal Ownership**

Determining who owns the assets of the PEPP invested in might be important as to determine the legal standing of the consumer towards the provider under the future PEPP initiative.

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<sup>353</sup> Art. 4(10) and (11) MiFID II. Art. 4(10) MiFID II; Annex II, I. Categories of client who are considered to be professionals, MiFID II.

<sup>354</sup> MiFID II and the AIFMD differentiate between professional and non-professional clients; The ProspectusD differentiates between qualified and non-qualified investors.

<sup>355</sup> See Art. 1(2) UCITS V.

<sup>356</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 51.

<sup>357</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 51.

EIOPA made a mapping exercise whether assets that are invested in PPPs in individual Member States are owned by consumers or not. EIOPA concluded that in half of the Member States, assets are owned by participants.<sup>358</sup> The study related to PPPs in individual Member States, however, does not accurately reflect the legal standing of consumers under the PEPP initiative for two reasons. First, the study differentiates between the legal systems of individual Member States without taking into account the nature of the underlying third-pillar retirement products available for investing. Non-insurance products by nature, such as UCITS/AIFs, are more often owned by consumers as compared to insurance products.<sup>359</sup> Second, the PPPs involved in the study do not necessarily fall within the scope of the PEPP initiative. National voluntary pension funds and 1st pillar products, for instance, most likely do not fall within the scope of the PEPP initiative.

The question is whether consumers or the PEPP providers will be the asset owners under the PEPP initiative. A PEPP must be based upon a contract or agreement between an individual and a financial institution.<sup>360</sup> In most cases, the PEPP provider will, thus, likely be the owner of the assets. Nevertheless, this might differ from case to case.<sup>361</sup>

The PEPP is a 'wrapper product'. A PEPP is a product consisting of eligible third-pillar products that have certain common features and comply with PEPP product regulation. The 'wrapper', i.e. common features and PEPP product regulation, might allow PEPP providers to alter the risk/reward and cost profile of the underlying third-pillar retirement products as regulated in current EEA sectoral legislation. The question whether the consumer or the PEPP provider are the asset owners depends upon (1) the underlying third-pillar retirement products and (2) the 'wrapper'.

#### 5.4.2.1. the Underlying Third-Pillar Retirement Product

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<sup>358</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 91/92.

<sup>359</sup> D.A. Zetzsch, *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012).

<sup>360</sup> Employers, therefore, do not play a role in establishing a PEPP, but may pay contributions to a PEPP of any individual; See European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, 7; European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 15; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 10; Employers do not play a role in establishing or sponsoring a PPP but may pay contributions to an individual PPP on behalf, or for the benefit, of the employee. Individuals can independently purchase and select material aspects of the arrangements. Self-employed persons are often seen as potential PPP members; European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 12-15.

<sup>361</sup> 'An important advantage of IDC schemes compared to traditional occupational DB schemes seems to be that the ownership of the assets lies unambiguously with the members of the pension fund through individual accounts'. See H. Van Meerten & P. Borsjé, *Pension Rights and Entitlement Conversion ('INVAREN')*, 54, [http://www.ejss.eu/pdf\\_file/ITS/EJSS\\_18\\_01\\_0046.pdf](http://www.ejss.eu/pdf_file/ITS/EJSS_18_01_0046.pdf) (access 22 December 2016).

Should PEPP providers not be allowed to significantly alter the risk/reward and the cost profile of the underlying third-pillar product, the status of asset ownership will depend upon the underlying third-pillar product as regulated in current EEA sectoral legislation. The choice of underlying eligible third-pillar retirement products are limited by the default ‘core’ investment option and the limited investment choices that all PEPPs as standardized or ‘mandatory’ features are obliged to have. Important to note is that the individual accounts of PEPP consumers (holders/owners)<sup>362</sup> under these features are not ‘baskets of assets’ like a managed account in which investors usually ‘own’ the assets but units reflecting ‘default options’.<sup>363</sup> Given the standardized mandatory features of PEPPs, AIFs, UCITS, IORPs and unit-linked insurances based upon the latter three types of ‘investment vehicles’ are the most suitable types of third-pillar retirement products that would be eligible for PEPPs. Whether consumers are PEPP ‘holders’, i.e. having a claim towards the PEPP provider as legal owner, or PEPP owners’, thus, depends in the first place upon the nature of the underlying third-pillar product.

Unit-linked insurances and other types of underlying insurance products are governed by Solvency II. In a PEPP based upon a contract or agreement between a consumer and an insurance company, the insurance company has the legal title of the assets invested in and the consumer have a claim towards the insurance company as PEPP provider. The consumer claim is backed up by underlying assets in, for instance, AIFs/UCITS. Unit-linked insurance, for instance, may diverge in terms of costs and return in comparison to the underlying investments in the AIFs/UCITS. Insurance companies under Solvency II are allowed to (unconditionally) guarantee investment returns and benefits and cover biometric risks. Insurance undertakings as PEPP providers, unlike AIFMs/UCITS ManCos, take principal risk<sup>364</sup> as they do not act as a mere service intermediary and are, therefore, subjected to capital requirements that underlie the ordinary contractual claims of consumers towards them. The market value of the assets invested in underlying UCITS/AIFs only partly fulfils the claim of the consumer to the insurance company. The insurance ‘wrapper’ consisting of ‘guarantees’ or other contractual covenants determining the return of the consumer, thus, alters the risk/reward profile for which the balance sheet and capital requirements of the insurance company will have to cover.

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<sup>362</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013.

<sup>363</sup> See Ireland, Sweden, UK ‘pooled’ accounts versus basket of assets: See for the Irish PRSA: Pensions (Amendment) Act, 2002; The Pensions Authority, Personal Retirement Savings Accounts (PRSAs) – A consumer and employer’s guide to PRSAs, [http://www.pensionsauthority.ie/en/Publications/Information\\_Booklets/PRSAs\\_-\\_a\\_consumer\\_and\\_employers%27\\_guide.pdf](http://www.pensionsauthority.ie/en/Publications/Information_Booklets/PRSAs_-_a_consumer_and_employers%27_guide.pdf) (accessed 14 January 2017); Sweden: The Individual Pension Savings Act(1993: 931); UK: There are two types of personal pension scheme: insured personal pensions, where each contract will have a set range of investment funds for planholders to choose from (this is not as restrictive as it sounds, as some modern schemes have over a thousand fund options) and self-invested personal pensions (SIPPs). See for insured personal pensions: S.43(1) Pensions Schemes Act; See for SIPPs: Finance Act 2004

<sup>364</sup> S.L. Schwarcz, *Intermediary Risk in a Global Economy*, 6 Duke Law Journal 1541 (2001).

Under the EEA sectoral legislation of non-insurance products, the question who is the legal owner of product is a bit more complicated.

Like insurance companies, credit institutions are under CRD IV the legal owners of the deposits of consumers. Consumers have a claim towards the credit institution. Credit institutions, therefore, are subjected to capital requirements under the CRR to be able to return the assets of the ordinary contractual claims of consumers towards them. The DGSD ensures the promise of a single credit institution towards the consumer upon a default of the customer.<sup>365</sup> The legal ownership matter is very complicated for UCITS and retail AIFs. The European implementations of these directives in various Member States do not show a consistent pattern. For UCITS/AIFs established in the corporate form, UCITS/AIFs have the legal title of the assets invested in and the investor a proportional claim as shareholders. For AIFs/UCITS that are not established in the corporate form, Member States have different solutions. Some Member States grant the legal title of the assets invested in to the UCITS ManCos and AIFMs, whereas other Member States grant the legal title to investors as ‘co-owners’ or the depositary. Recent research indicates that it is indifferent to whom the legal title of the assets invested in for non-corporate AIFs/UCITS is attributed.<sup>366</sup> Non-corporate AIFs/UCITS might be established as common fund, investment limited (liability) partnership or unit trusts.<sup>367</sup> Regardless of to whom the legal title is formally being attributed, the eventual outcome is under all non-corporate legal forms employed the same. Investors do not have legal, but economic ownership. This is the result of private law arrangements being replaced by regulatory law in the form of the AIFMD/UCITSD V that makes the legal title matter unimportant. Both the AIFMD and UCITSD V require a so-called ‘investment triangle’ model to be employed.<sup>368</sup> The investment triangle involves an AIFM/UCITS ManCo, a depositary and the joint investors. When the legal title is attributed to the AIFM/UCITS ManCo or the depositary on behalf of the UCITS/AIF or its investors, the assets formally are part of the legal entity in which the AIFM/UCITS ManCo or the depositary is established in. The latter intermediaries, however, are under regulatory law limited in ‘abusing’ their power as legal owner. The AIFMD/UCITSD V require AIFMs and UCITS ManCos to perform ‘investment management’, marketing or administration on behalf of the AIFs/UCITS they manage regardless of the legal form of the AIF/UCITS or the legal title of the assets. The mandatory appointment of a depositary ensures that the assets of the AIF/UCITS are (administratively) segregated from the assets of (1) other clients, including other UCITS/AIFs, IORPs or individual investment portfolios and (2) the operational assets belonging to the UCITS

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<sup>365</sup> Recital 3, Art. 5 DGSD.

<sup>366</sup> Cf. J.W.P.M. van der Velden, *Hoofdstuk 25 Beleggingsinstelling en aansprakelijkheid in het zicht van de nieuwe regelgeving*, in *Aansprakelijkheid in de Financiële Sector* 976-977 (D. Busch, C.J.M. Klaassen & T.M.C. Arons, Kluwer Law 2013).

<sup>367</sup> D.A. Zetzsche, *Die Irrelevanz und Konvergenz des Organisationsstatus von Investmentfonds*, ZVglRWiss 111, 371 (2012); D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 19 (Mohr Siebeck 2015).

<sup>368</sup> See D.A. Zetzsche, *Investment Law as Financial Law: From Fund Governance over Market Governance to Stakeholder Governance?*, in *The European Financial Market in Transition* (H. S. Birkmose, M. Nevillie & K. E. Sørensen eds., Kluwer 2012); See S.N. Hooghiemstra, *Depositary Regulation* 480 (D. Zetzsche ed, Kluwer 2015).

ManCo/AIFM and the depositary itself. This is being done by the depositary that keeps financial instruments that can be held in custody in accounts that can be separately identified. The depositary keeps record of those assets that cannot be held in custody. The role of the depositary, thus, ensures that the assets of AIFs/UCITS are at all times to be separately identifiable of the assets of the UCITS ManCo/AIFM, the depositary itself and the individual investors investing in the UCITS/AIF. Member States providing for ‘common funds’, i.e. contractually established AIFs/UCITS, determine in their implementation laws that investors are ‘co-owners’ of the invested assets. Co-ownership in this regard, however, should not be seen as ‘co-ownership’ under the property laws of individual Member States.<sup>369</sup> If this would be the case, this would lead to undesirable situations in which individual investors would be able to ‘claim’ assets at all times. Instead, ‘co-ownership’ should be understood as economical ownership of ‘pooled assets’ under regulatory law to which investors are collectively legally entitled under the premise that the entry and exit from the fund takes place under the conditions set out in the fund rules. The ‘pooled assets’ are again to be held by a depositary. The investment triangle is, thus, a ‘trust system’ in which legal and economical ownership are split under the regulatory laws of both Anglo Saxon and Continental legal traditions and in which the legal ownership of intermediaries and the power derived from it are mitigated by the fund rules, as well as, any formal ‘co-ownership’ of the joint investors. In property law terms, the absolute (‘erga omnes’ rights of the legal ownership is being relativized by the fund rules (‘in personam rights’). The depositary plays an essential role in administrative asset segregation as to ensure limited liability for the investors and keeping the assets as independent ‘asset patrimony’ insulated from the private creditors of the depositary, UCITS ManCos/AIFMs and their clients.

The legal ownership of the IORP’ assets is an even more complicated matter. Depending upon the Member State implementation of the IORPD II, IORPs might be an insurance product, pension fund, an investment fund or a combination of these.<sup>370</sup>

Full DC IORPs may be regarded as ‘investment funds’ as they do not guarantee investment returns nor benefits. They are, thus, not underwriting any (biometric) risks. Regardless of the legal form employed by this type of IORP, the same academic discussion applying to AIFs/UCITS regarding legal ownership applies to these type of IORPs.<sup>371</sup>

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<sup>369</sup> D.A. Zetzsche, D., *Prinzipien der kollektiven Vermögensanlage* § 24 C. I. 1. (Mohr Siebeck 2015).

<sup>370</sup> H. Van Meerten, *The scope of the EU ‘Pensions’-Directive: Some Background and Solutions for Policymakers* (U. Neergaard, E. Szyszczak, J.W. van de Gronden & M. Krajewski eds, T. M. C. Asser Press 2013); H. Van Meerten, A. van den Brink & S.A. de Vries, *Regulating Pensions: Why the European Union Matters* (Netspar Discussion Paper) 38, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1950765](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1950765) (accessed 4 October 2016).

<sup>371</sup> ‘Pension entity: a special-purpose legal entity, such as a trust, foundation, or a corporate entity that owns and may also control the pension fund on behalf of the pension plan/fund members. Plan members may have either a legal or a beneficial ownership right over the pension fund, or a contractual claim against the special purpose entity with respect to their rights to the pension fund assets.’ See J. Yermo, *Revised Taxonomy for Pension Plans, Pension Funds and Pension Entities*, October 2002, Section 3, <http://www.oecd.org/pensions/private-pensions/2488707.pdf> (accessed 14 January 2017)



Hybrid IORPs, such as CDC products, and DB IORPs, in contrary, do provide investment and benefit returns to some extent. There are two types of IORPs: (1) IORPs covering for the principal risk by their own balance sheet and (2) IORPs in which the employer guarantees with its balance sheet the claims of members/beneficiaries towards the IORP.<sup>372</sup> IORPs that take the principal risk themselves are required under the Member State implementations of IORPD II to comply with technical provisions, own funds and other capital requirements.<sup>373</sup> These IORPs are, thus, allowed to underwrite biometric risks and resemble to some extent insurance undertakings.

#### 5.4.2.2. The ‘Wrapper’

Regardless of the legal ownership status of PEPP providers and consumers under sectoral legislation, PEPP providers may alter the risk/reward and cost profile of the underlying third-pillar product. Given the current PPP landscape and the expected PEPP provider and product regulation, this should be possible. For instance, AIFMs/UCITS ManCos would possibly be allowed to offer a DC PEPP which fully reflects the product requirements under the AIFMD/UCITSD V. Although they are under the AIFMD/UCITSD V not allowed to insure investment guarantees or benefits, they might under the PEPP initiative be allowed to offer such investment and benefit guarantees by concluding an insurance contract with an insurance company that is allowed to do so under sectoral legislation as a contracting party on behalf of PEPP consumers. This significantly alters the risk/reward profile of the underlying AIF/UCITS and the risks consumers bear.

Given the ‘wrapper nature’ of the PEPP that might significantly diverge from the underlying third-pillar product, it is safe to say that the assets accumulated in individual PEPP accounts in the course of the investment of the contributions are legal owned by the PEPP provider as a legal entity.<sup>374</sup> Consumers are then entitled to a proportional share based on the actual contributions that could be paid out in the form of their respective benefits or transferred to other providers.<sup>375</sup>

#### 5.4.3 Inheriting PEPPs

Till now, neither EIOPA nor the European Commission has dealt with the issue of whether PEPPs will be inheritable or not. The European Financial Services Round Table in 2007

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<sup>372</sup> H. Van Meerten, *Pensions Reform in the European Union: Recent Developments after the Implementation of the IORP Directive*, 14 *Pensions: An International Journal* 4 (2009).

<sup>373</sup> Title II, Title V IORPD II.

<sup>374</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457; See also H. van Meerten, *Individueel Eigendomsrecht in Een Beschikbarepremieregeling*, <https://ssrn.com/abstract=2781207> (access 22 December 2016); H. van Meerten & P. Spiertz, *Kan het Europese eigendomsrecht pensioen veilig stellen?*, *Pensioen & Praktijk*, 2016, 1.

<sup>375</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, p. 91, 92.

considered that this issue should be left to the laws of the individual Member States to decide upon.<sup>376</sup> The inheritance laws of individual Member States, as well as, the taxation of inheritances varies from Member State to Member State.<sup>377</sup>

In determining whether the PEPP would need to be inheritable or not, the accumulation phase should be delineated from the payout phase.

#### **5.4.3.1 Accumulation Phase**

Similar as for the legal ownership issue, determining whether PEPPs should be inheritable or not in the accumulation phase in the PEPP initiative is difficult due to (1) the different underlying eligible third-pillar retirement products and (2) the ‘wrapper’ nature of the PEPP initiative.

Eligible third-pillar retirement products under the PEPP initiative contain insurance, as well as, non-insurance products. Non-insurance products, such as the units of UCITS and AIFs are, generally, inheritable under Member State laws. Insurance products, such life insurances, are, however, not considered to be part of the beneficiary's inheritance. The different nature of the underlying investment products under the PEPP initiative make this issue very complicated.

The ‘wrapper’ nature of the PEPP initiative even makes this issue more complicated. A non-insurance product, such as an AIF or UCITS, may under the PEPP initiative, as proposed in this Report, contain an investment guarantee under the condition that a contract is being concluded by a consumer or on behalf of a consumer with an insurer. Some PEPPs, thus, may be ‘hybrid’ products.

A level playing-field between insurance and non-insurance based PEPPs concerning the inheritance issue in the accumulation phase is, thus, difficult to be achieved in the PEPP initiative itself due to the differences between third-pillar retirement products and the ‘wrapper’ nature of the PEPP.

#### **5.4.3.2 Payout Phase**

The inheritance issue is different in the payout phase. Regardless of the underlying third-pillar retirement product and the PEPP ‘wrapper’ nature, the inheritability of PEPPs in the payout phase depends upon the payout solution chosen. Under this Report, PEPP providers are allowed to offer payout solutions that include lump sums, phased drawdown plans and, depending upon the nature of the provider, annuities.<sup>378</sup> Lump sums and phased drawdowns are inheritable,

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<sup>376</sup> European Financial Services Round Table, *Pan-European Pension Plans, From Concept to Action*, EFR, 2007, 12, <http://www.efr.be/documents%5Cpublication%5C76309EPP%202007.pdf> (accessed 14 January 2017).

<sup>377</sup> Cf. the former ‘punitive death tax’ in the UK: J. Cumbo, *Pensions: understanding the new rules on inheritance*, FT, 19 August 2015.

<sup>378</sup> P. Antolin, C. Pugh, & F. Stewart, *Forms of Benefit Payment at Retirement*, OECD Working Papers on Insurance and Private Pensions No. 26 (2008) <http://www.oecd.org/dataoecd/39/4/41408028.pdf> (accessed 14 January 2017).

whereas annuities are not inheritable. The inheritability, thus, depends upon the payout solution chosen by the consumer regardless of what type of PEPP product was being bought in the accumulation phase.

#### 5.4.3.3 The Solution: ‘Contractual Freedom’

The solution for the complicated inheritance issue in the accumulation phase would be to allow this to be individually agreed upon by the PEPP provider and the consumer. Under the Dutch second-pillar PPI law, for example, such a ‘contractual freedom solution’ already exists, i.e. the agreement concluded between employers and PPIs may contain arrangements on inheritance. In this regard, the Explanatory Note on the PPI legislation stipulates that<sup>379</sup>

‘the agreement may contain provisions regarding provision of information to pension participants and pension beneficiaries, the assignment of mortality profits (total value of the claims of pension participants who decease before the conversion date which remains part of the pension assets), the policy of the premium pension institution regarding selection of a third party to execute payment of the pension moneys in the benefit phase, the covering of biometrical risks or (profit) guarantees of third parties, governance regarding the operation of the pension scheme and the tax treatment of pension claims.’

Making a definite choice whether a certain PEPP product in the accumulation phase would be inheritable or not would limit the product range to be offered and the choice for consumers. For example, consumers without spouse and children maybe would like to ‘leverage’ their investment by investing in a PEPP that abides by the ‘tontine principle’, i.e. the returns of the consumers are based upon both the investment return of the underlying assets and the death rate of the other consumers investing in the underlying investment option. In turn, the consumer chooses his investment not to be inheritable. The consumer, thus, substitutes the inheritance of his investments for the opportunity to increase his investment return. A ‘contractual freedom solution’, as under the Dutch second-pillar PPI law, could, thus, be of value to PEPP providers that are willing to offer a large variety of PEPP products and consumers willing to obtain a higher investment return.

The ‘contractual freedom solution’, however, only could be implemented under the condition that consumers are making an informed investment decision. Disclosure in the pre-contractual and payout phase about the inheritance implications of their investment decision chosen would be of the essence to allow consumers to make the right choice for them that accommodates their personal circumstances. In addition, disclosure in both the pre-contractual and payout phase allows consumers to conclude a life insurance with an insurance company, along their PEPP investment, to cover adverse consequences of non-inheritability of their PEPP product that they have invested in. The contractual freedom solution, ultimately, will be influenced by the general inheritance and taxation laws of individual Member States.

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<sup>379</sup> Dutch Parliament: TK, 31891, nr.3.

## 6 Taxation

Taxation (of third-pillar retirement products) varies from Member State to Member State. Some Member States do not or hardly facilitate third-pillar private pensions by means of taxation, whereas other Member States allow deductions with the maximum deduction of contributions that applies to contributions of all three pillars.<sup>380</sup> Some Member States only allow deductions of contributions if there is a ‘pension gap’.<sup>381</sup>

The Member States that do provide tax incentives apply different tax arrangements and conditions for granting tax relief for contributions.<sup>382</sup> The vast majority of the Member States employs the EET system (Exempt contributions, Exempt investment income and capital gains of the pension institution, Tax benefits) and some Member States, such as Sweden, the ETT system (Exempt contributions, Tax investment income and capital gains of the pension institution, Tax benefits).<sup>383</sup> Other taxation systems, such as TET, TEE, EEE systems, are less common but also found across the EEA.<sup>384</sup> The different tax systems that will apply in the EEA possibly may lead to tax hurdles/problems that affect the effectiveness of the pan-European PEPP initiative.

The European Commission and various interest groups have expressed their concern that tax obstacles could prevent the creation of an effective single market for PEPPs.<sup>385</sup> In particular,

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<sup>380</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 144 (2007).

<sup>381</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 144 (2007).

<sup>382</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

<sup>383</sup> Federation for Retirement Provision, *The EFRP model for pan-European pensions*, October 2003, <http://www.pensionseurope.eu/system/files/EIORP%202005%20Report%20-%20European%20Institutions%20for%20Occupational%20Retirement%20Provision%20-%20The%20EFRP%20Model%20for%20pan-European%20pensions%20-%20October%202003.pdf> (accessed 13 January 2017); As noted in the Commission's Pension Taxation Communication, ‘much of the discussion in this Communication applies equally to third pillar pension and life assurance services’; See Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 6, 7; B. Starink, G. Dietvorst & M. Visser, *De fiscaliteit en pensioen: Naar een nieuw fiscaal pensioenkader?*, Netspar NEA (2016), 10, [https://pure.uvt.nl/portal/files/12769981/P20160819\\_occ001\\_Starink.pdf](https://pure.uvt.nl/portal/files/12769981/P20160819_occ001_Starink.pdf) (accessed 14 January 2017); B. Starink, *Up to a New System of Taxing Cross-Border Pension Payments: Back to Basics?*, 3-5 [https://www.cesifo-group.de/dms/ifodoc/docs/Akad\\_Conf/CFP\\_CONF/CFP\\_CONF\\_2015/tag15-Holzmann/tag15-Starink.pdf](https://www.cesifo-group.de/dms/ifodoc/docs/Akad_Conf/CFP_CONF/CFP_CONF_2015/tag15-Holzmann/tag15-Starink.pdf) (accessed 14 January 2017).

B. Starink, *Belastingheffing over particulier pensioen en overheidspensioen in grensoverschrijdende situaties*, 41-63, [https://pure.uvt.nl/portal/files/5672783/dissertatie\\_Bastiaan\\_Starink.pdf](https://pure.uvt.nl/portal/files/5672783/dissertatie_Bastiaan_Starink.pdf) (accessed 14 January 2017); G. Staats, *Personal Pensions in the EU*, 13, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>384</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

<sup>385</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 37.

taxation issues could prevent mobile consumers to move between certain Member States. Tax hurdles would decrease the effective benefits of the PEPP product passport for non-mobile consumers as PEPP providers might choose not to offer their PEPPs in all Member States thereby limiting the supply-side of PEPPs in certain Member States leading to less scale and scope of economies, higher costs and less innovation.<sup>386</sup>

### **6.1. Tax Problems/Hurdles**

Various types of tax hurdles/obstacles have been identified to the cross-border provision of PEPPs, including tax discrimination, system diversity and the ‘pensionista problem’.<sup>387</sup> These three problems or not necessarily a hurdle/problem by itself but they are also strongly interconnected.

#### **6.1.1 Tax Discrimination**

The first problem relates to tax discrimination, i.e. Member State tax laws that do not treat EEA and domestic PEPPs or PEPP providers equally.<sup>388</sup> In recent years, CJEU case law has concluded that all national restrictions impeding cross-border provision of pensions without objective justification infringe the EC Treaty.<sup>389</sup> In particular, these relate to three main obstacles for PEPPs as identified by EIOPA and the European Commission.<sup>390</sup> The first relates to the non-deductibility of pension contributions paid to foreign pension funds.<sup>391</sup> Member States are required to grant the same tax benefits applicable to domestic PEPPs to EEA

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<sup>386</sup> D.A. Zetsche, *Drittstaaten im Europäischen Bank- und Finanzmarktrecht* (G. Bachmann & B. Breig eds., Mohr Siebeck, Tübingen 2014), 63-66; European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 37.

<sup>387</sup> Cf. B. Starink & H. Van Meerten, *Cross-border obstacles and solutions for pan-European pensions*, 1 EC Tax Review 30 (2011); H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 22, <https://ssrn.com/abstract=2425478> (accessed 14 January 2017).

<sup>388</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 7-14; G. Staats, *Personal Pensions in the EU*, 267, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>389</sup> P. Schonewille, *To what extent is tax still an issue for IORPS?*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ipe\\_sep2005.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ipe_sep2005.pdf) (accessed 13 January 2017); P. Schonewille, *The elimination of tax obstacles to pan-European pension funds: An overview*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/occ\\_pen\\_article3.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/occ_pen_article3.pdf) (accessed 13 January 2017).

<sup>390</sup> P. Schonewille, *Pan-European pension moves a step nearer*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ipe\\_mar2007.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ipe_mar2007.pdf) (accessed 13 January 2017); P. Schonewille, *Disappearing Tax Obstacles*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/occ\\_pen\\_article.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/occ_pen_article.pdf) (accessed 13 January 2017).

<sup>391</sup> P. Schonewille, *France and Spain end tax discrimination of foreign pension funds*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/occ\\_pen\\_article2.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/occ_pen_article2.pdf) (accessed 13 January 2017).

PEPPs.<sup>392</sup> Domestic tax relief has to also be granted to EEA PEPP providers in order to avoid unjustified discriminatory treatment on the basis of nationality.<sup>393</sup> This does, however, not address the differences in Member State tax arrangements and conditions for granting tax relief for contributions.<sup>394</sup> Although most Member States employ an EET system, the requirements for tax deductibility of contributions vary from Member State to Member State and are also often limited to a certain level of income or to a fixed amount.<sup>395</sup>

The second obstacle is the taxation of investment income paid to foreign PEPPs.<sup>396</sup> Foreign PEPPs may suffer differential treatment compared to domestic PEPPs. Again, the CJEU has confirmed that this constitutes discrimination on the basis of nationality that infringes the free movement of capital.<sup>397</sup> Member States, are however, only required to remove tax obstacles to the extent that they treat EEA PEPP providers equally compared to domestic PEPP providers. CJEU case law does not address differences among Member States in taxation of investment income that result from system diversities. For example, PEPP investment income may be tax exempted in the Member State of residence of the PEPP holder or receive a credit for withholding taxes levies on their domestic investment income.<sup>398</sup> Despite of this, PEPPs may be subject to source taxation in other Member States on foreign investment income which

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<sup>392</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 36.

<sup>393</sup> In Case C-150/04 *Commission v Denmark* the CJEU concluded that ‘introducing and maintaining in force a system for life assurance and pensions under which tax deductions and tax exemptions for payments are granted only for payments under contracts entered into with pension institutions established in Denmark, whereas no such tax relief is granted for payments made under contracts entered into with pension institutions established in other Member States the Kingdom of Denmark has failed to fulfil its obligations under Articles 39 EC [free movement of workers], 43 EC [freedom of establishment] and 49 EC [freedom to provide services]’.

;See also Case C-118/96 *Safir* and Case C-204/90 *Bachmann*; European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 36.

<sup>394</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

<sup>395</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

<sup>396</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 36.

<sup>397</sup> In Case C-493/09 *Commission v Portugal* the CJEU concluded that ‘[...]by reserving the benefit of the corporation tax exemption to pension funds resident in Portuguese territory alone, the Portuguese Republic has failed to fulfil its obligations under Article 63 TFEU and Article 40 of the Agreement on the European Economic Area of 2 May 1992’; See also European Federation for Retirement Provision and PricewaterhouseCoopers, *Executive summary of the report supporting the complaint filed with the EC „Discriminatory treatment of EU pension funds making cross-border portfolio investments in bonds and shares within the European Union“*, <http://www.efrp.org/LinkClick.aspx?fileticket=A2oE2tzHLhQ%3D&tabid=1564> (accessed 14 January 2017).

<sup>398</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.



results in a tax burden as this investment income from the perspective of the Member State of residence of the PEPP holder is tax exempt.<sup>399</sup>

The third obstacle is the differential treatment of the taxation of transfers of accumulated capital from the one to the other Member State.<sup>400</sup> When a PEPP holder wants to switch between PEPPs or change PEPP providers there might be a transfer of accumulated capital from the one Member State to a PEPP in another Member State that is subject to a withholding tax in the exiting Member State or even a prohibition of the transfer.<sup>401</sup> The CJEU has held that there is unjustifiable discrimination when domestic transfers are tax free.<sup>402</sup> When domestic transfers are taxed the exiting Member State is, however allowed to levy an exit tax.<sup>403</sup> Double taxation preventing the switching of PEPPs/PEPP providers may occur when the Member State to which the transfer is made levies an entry tax on the transferred capital. This discourages the switching of PEPPs and PEPP providers.

Discriminatory treatment of contributions paid to foreign PEPPs and benefits received from foreign PEPP providers, investment income paid to foreign EEA PEPPs and the transfer of accumulated PEPP capital are, thus, prohibited by primary EU law. Nevertheless, CJEU case law has limited effectiveness as the three obstacles/hurdles may still take place as a result of system diversities.<sup>404</sup>

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<sup>399</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

<sup>400</sup> P. Schonewille, *ECJ clears way for tax free transfers*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ipe\\_sep2007.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ipe_sep2007.pdf) (accessed 31 January 2017); European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 36.

<sup>401</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

<sup>402</sup> Case C-522/04 *Commission v Belgium* concluded that 'levying tax [...] on transfers of capital or surrender values built up by means of employers' contributions or personal contributions for supplementary retirement benefits, where the transfer is made by the pension fund or insurance institution with which the capital or surrender values have been built up in favour of the beneficiary or persons entitled through him, to another pension fund or insurance institution established outside Belgium, while such a transfer does not constitute a taxable transaction if the capital or surrender values are transferred to another pension fund or insurance institution established in Belgium' is inconsistent with EU primary law on fundamental freedoms of internal market.

<sup>403</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 36.

<sup>404</sup> European Financial Services Round Table, *One Europe, One Pension – Affording the Future*, EFR, 2002, [www.efr.be/documents/publication\02.2002.06](http://www.efr.be/documents/publication\02.2002.06). One Europe One Pension June2002.pdf (accessed 13 January 2017); European Financial Services Round Table, *Creating a Common Structure for Pan-European Pension*, Recommendations of the European Financial Services Round Table, EFR, 2004, <http://www.efr.be/documents%5Cpublication%5C53351Penreco.pdf> (accessed 13 January 2017); European Financial Services Round Table, *Pan-European Pension Plans, Deepening the Concept*, EFR, 2005, <http://www.efr.be/documents%5Cpublication%5C26.2005.12.%20EFR%20Report%20-%20Follow->



### 6.1.2 System Diversity

Differences in Member States' tax treatment of PEPPs, so-called 'system diversities', may lead to double (non) taxation.<sup>405</sup> For example, the transfer of accumulated capital from a Member State with a TEE/TTE system to a EET/ETT Member State may lead to double taxation.<sup>406</sup> The CJEU cases on non-discrimination do not eliminate the problems related to system diversities. The problem is that direct taxation is still within the competence of individual Member States.<sup>407</sup> Taxation issues resulting in double (non) taxation could only be remedied by harmonizing the tax treatment of PEPPs across Member States, the adoption of unilateral domestic rules or the revision of existing tax treaties.<sup>408</sup>

### 6.1.3 Mobile vs. Non-Mobile Consumers and the 'Pensionista Problem'

The increasing mobility of consumers and the different treatment of third-pillar PPPs for taxation purposes across the EEA may provide an incentive for wealthy pensioners ('pensionistas')<sup>409</sup> to take taxation into account in their migration decision. Prior to addressing

up%20on%20Pan%20European%20Pensions%20plans%2020Dec2005.pdf (accessed 13 January 2017), European Financial Services Round Table, *Pan-European Pension Plans*,

*From Concept to Action*, EFR, 2007, <http://www.efr.be/documents%5Cpublication%5C76309EPP%202007.pdf> (accessed 13 January 2017).

<sup>405</sup> Cf. the definition for occupational pensions: European Federation for Retirement Provision, *The EFRP model for pan-European pensions*, October 2003, 31, <http://www.pensionseurope.eu/system/files/EIORP%202005%20Report%20-%20European%20Insitutions%20for%20Occupational%20Retirement%20Provision%20-%20The%20EFRP%20Model%20for%20pan-European%20pensions%20-%20October%202003.pdf> (accessed 13 January 2017).

<sup>406</sup> International Fiscal Association, *Double non-taxation*, (Kluwer 2004); European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59; European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 37.

<sup>407</sup> In Case C-96/08 CIBA Speciality Chemicals Central and Eastern Europe Szolgáltató, Tanácsadó és Kereskedelmi kft v Adó- és Pénzügyi Ellenőrzési Hivatal (APEH) Hatósági Főosztály the CJEU notes that 'in the current state of the development of European Union law, the Member States enjoy a certain autonomy in this area provided they comply with European Union law, and are not obliged therefore to adapt their own tax systems to the different systems of taxation of the other Member States in order, inter alia, to eliminate the double taxation arising from the exercise in parallel by those States of their fiscal sovereignty'.

<sup>408</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59; European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 37.

<sup>409</sup> European Federation for Retirement Provision, *The EFRP model for pan-European pensions*, October 2003, 10, 31 et seq. <http://www.pensionseurope.eu/system/files/EIORP%202005%20Report%20-%20European%20Insitutions%20for%20Occupational%20Retirement%20Provision%20-%20>

this problem, it is necessary to define what ‘mobile’ and ‘non-mobile’ consumers are.<sup>410</sup> ‘Non-mobile consumers’ are consumers that are resident in a Member State and either invest in PEPPs residing in that Member State or in PEPPs residing in other Member States.<sup>411</sup> Under the non-discrimination CJEU case law, the conditions imposed by Member States related to the deductibility of contributions paid into a PEPP established in another Member State than the residence of the consumer are required to apply equally and to the same extent as domestic PEPPs.<sup>412</sup> The conditions may relate to, the nature and level of benefits, age of retirement, qualifying beneficiaries and should be proportionate to the objectives to be achieved.<sup>413</sup>

‘Mobile consumers’ are consumers from a Member States that either invest in PEPPs residing in that Member State or in PEPPs residing in other Member States<sup>414</sup> and that move (temporarily) to another Member State prior to retirement. Under most double taxation conventions<sup>415</sup> the Member State to which a migrant has moved is entitled for taxation purposes to fully tax or not future PEPP pension benefits.<sup>416</sup> The main

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%20The%20EFRP%20Model%20for%20pan-European%20pensions%20-%20October%202003.pdf (accessed 13 January 2017).

<sup>410</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 13,14; European Federation for Retirement Provision, *The EFRP model for pan-European pensions*, October 2003, 32, <http://www.pensionseurope.eu/system/files/EIORP%202005%20Report%20-%20European%20Insitutions%20for%20Occupational%20Retirement%20Provision%20-%20The%20EFRP%20Model%20for%20pan-European%20pensions%20-%20October%202003.pdf> (accessed 13 January 2017).

<sup>411</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 13,14; European Federation for Retirement Provision, *The EFRP model for pan-European pensions*, October 2003, 32, <http://www.pensionseurope.eu/system/files/EIORP%202005%20Report%20-%20European%20Insitutions%20for%20Occupational%20Retirement%20Provision%20-%20The%20EFRP%20Model%20for%20pan-European%20pensions%20-%20October%202003.pdf> (accessed 13 January 2017).

<sup>412</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 13,14.

<sup>413</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 18.

<sup>414</sup> European Federation for Retirement Provision, *The EFRP model for pan-European pensions*, October 2003, 32, <http://www.pensionseurope.eu/system/files/EIORP%202005%20Report%20-%20European%20Insitutions%20for%20Occupational%20Retirement%20Provision%20-%20The%20EFRP%20Model%20for%20pan-European%20pensions%20-%20October%202003.pdf> (accessed 13 January 2017); Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 13,14.

<sup>415</sup> See Art. 18 OECD Model Tax Convention.

problem is that not all EEA Member States have adopted an EET or ETT system, but some Member States have TEE and EEE systems.<sup>417</sup> ‘Pensionistas’ that have invested tax exempt contributions when residing in a Member State that applies a deferred tax system, such as the EET system, that move nearing the pension age to a Member State applying a TEE system effectively may set-up a tax route that leads to an ‘artificial EEE system’ in which the contributions, investment income and benefits are not taxed at all or achieve a lower rate.<sup>418</sup> Some Member State policies, such as Portugal, even exacerbate this problem by designing a tax favourable regime for ‘pensionistas’ that includes low tax rates for new arrivals and a tax exemption on foreign income during a period of ten years.<sup>419</sup>

Member States with EET/ETT systems, for example, increasingly counteract by adopting ‘source taxation clauses’<sup>420</sup> in double taxation agreements with Member States employing TEE/EEE systems. The latter is, however, a burdensome negotiation process and in Member States in which such a double taxation agreement is not in place the taxation of benefits is the only tax that remains to be relevant and makes a difference for the net benefit income.<sup>421</sup> It would be, however, a mistake to only deem the taxation rate on pension benefits relevant for migration systems as many Member States with higher taxes tend to provide better social benefits.<sup>422</sup>

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<sup>416</sup> B. Starink, *Belastingheffing over particulierpensioen en overheidspensioen in grensoverschrijdende situaties*, 63- 115, [https://pure.uvt.nl/portal/files/5672783/dissertatie\\_Bastiaan\\_Starink.pdf](https://pure.uvt.nl/portal/files/5672783/dissertatie_Bastiaan_Starink.pdf) (accessed 14 January 2017).; G. Staats, *Personal Pensions in the EU*, 24, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017); P. Kavelaars, A. de Graaf & A. Stevens, *Internationaal belastingrecht* 13 (Kluwer 2007).

<sup>417</sup> E. Whitehouse, *The Tax Treatment of funded Pensions*, World Bank Pension Reform Primer Series (2005), <https://search.oecd.org/finance/private-pensions/2391559.pdf> (accessed 14 January 2016).

<sup>418</sup> A.M. Williams & T. Wames, *A Place in the Sun. International Retirement Migration from Northern to Southern Europe*, 4(2) *European Urban and Regional Studies* 115–34 (1997).

<sup>419</sup> European Federation for Retirement Provision, *The EFRP model for pan-European pensions*, October 2003, 10, 31 et seq. <http://www.pensionseurope.eu/system/files/EIORP%202005%20Report%20-%20European%20Institutions%20for%20Occupational%20Retirement%20Provision%20-%20The%20EFRP%20Model%20for%20pan-European%20pensions%20-%20October%202003.pdf> (accessed 13 January 2017); V. Meier & A. Wagener, *Do Mobile Pensioners Threaten the Deferred Taxation of Savings?*, 61 (2) *CESifo Economic Studies* 465–483 (2015).

<sup>420</sup> See for example, the Netherlands-Portugal tax treaty.

<sup>421</sup> European Federation for Retirement Provision, *The EFRP model for pan-European pensions*, October 2003, 10, 31 et seq. <http://www.pensionseurope.eu/system/files/EIORP%202005%20Report%20-%20European%20Institutions%20for%20Occupational%20Retirement%20Provision%20-%20The%20EFRP%20Model%20for%20pan-European%20pensions%20-%20October%202003.pdf> (accessed 13 January 2017).

<sup>422</sup> A. Xu, *Pension Taxation in the EU: A Concern for Mobile Pensioners?*, CESifo DICE Report, September 2015, [https://www.cesifo-group.de/ifoHome/facts/DICE/Social-Policy/Pensions/Finances/DR-2015-3\\_Xu\\_Pension-taxation-EU/fileBinary/DR-2015-3\\_Xu\\_Pension-taxation-EU.pdf](https://www.cesifo-group.de/ifoHome/facts/DICE/Social-Policy/Pensions/Finances/DR-2015-3_Xu_Pension-taxation-EU/fileBinary/DR-2015-3_Xu_Pension-taxation-EU.pdf) (accessed 14 January 2017); V. Meier & A. Wagener, *Do Mobile Pensioners Threaten the Deferred Taxation of Savings?*, 61 (2) *CESifo Economic Studies* 465–483 (2015).

## **6.2. Dealing with the Hurdles of possible PEPP Member States' Tax Arrangements**

Tax obstacles arising from discrimination have been effectively removed in the past two decades by CJEU case law. The differences between the taxation systems of Member States related to the deductibility of contributions and the taxation of benefits, however, remain to pose a problem for migrant workers or retirees moving to other Member States as these are not to be eliminated by CJEU case law.<sup>423</sup> The double (non) taxation arising from system diversities. System diversities arise from differences between domestic tax rules and the tax treaty practice of Member States that mostly follows the OECD Model Tax Convention under which pensions are taxable in the Member State of residence regardless whether this was the Member State where contributions were deducted.<sup>424</sup> In discussing how to overcome these hurdles, a tax incentive system of preference, such as the EET principle for PEPPs, a solution for the 'pensionista problem' and the co-existence of different systems would have to be considered.

### **6.2.1 Extending the EET Principle to PEPPs?**

#### **6.2.1.1 EEE, EET, TEE or ETT?**

Taxation of third-pillar retirement products varies from Member State to Member State. Not all Member States have tax incentives in place for third-pillar personal pensions. The Member States that do provide tax incentives mostly apply the EET system.<sup>425</sup> Although some Member States also employ TEE, ETT and EEE systems, the European Commission and most academics agree that a broader acceptance of the EET system in Europe would be the most

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<sup>423</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 18.

<sup>424</sup> Art. 18 OECD Model Tax Convention; G. Staats, *Personal Pensions in the EU*, 24-28, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017); Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 18; See for the tax treaty policies of Germany, the Netherlands, Sweden and the UK related to this issue: G. Staats, *Personal Pensions in the EU*, 29-38, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017); See for the unilateral measures in Germany: D. Wellisch, *Internationaler Vergleich der steuerrechtlichen Forderung von Altersvorsorgeaufwendungen und deren Besteuerung bei Wegzug des Berechtigten ins Ausland*, Monatsbericht des BMF 2008; See for the Netherlands: Ministry of Finance, *Notitie Fiscaal Verdragsbeleid 2011*, IFZ/2011/100 M1, 11 February 2011.

<sup>425</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

practical solution.<sup>426</sup> It would, thus, be logical that the European Commission would support a broad acceptance of the EET principle for PEPPs.

Research is controversial whether tax incentives lead to more investments in the occupational and personal pension domain.<sup>427</sup> Tax incentives seem to, however, increase both occupational and personal pensions.<sup>428</sup> The PEPP combined with an EET system ensures that PEPP holders do use the accrued investment for retirement provision. The PEPP product regime and most of the Member State tax incentives do not allow taxpayers to use the accrued investments for other purposes. Providing a tax incentive to ensure adequate income for the taxpayer in the future is, thus, merely shifting savings and consumption to locked-in pension savings.

The EEE could be an interesting alternative. Agreeing upon an EEE system on the European level would allow PEPP holders to invest and reduce their chance of poverty during retirement.<sup>429</sup> Also this would be a way to unburden the pay-as-you-go and prevent a conflict of generations.<sup>430</sup> Without limitations, this system could, however, lead to disproportional pension savings by higher income groups.<sup>431</sup> By targeting this system to lower and medium income groups, the EEE system would achieve its goal. Nevertheless, lower and medium income groups are unlikely to invest in PEPPs as their income, apart from mandatory first and second pillar pension savings, is spent on basic needs. In addition, this system has severe budgetary implications. Investments are not deferred income for tax purposes, but not taxed for income taxation purposes at all. Indeed, Member States would partly unburden themselves in combating retirement poverty. The main problem seems to be that such a system would need to be fully harmonized on the European level. Without a 'hard law' European initiative, Member States could decide for themselves whether or not to implement an EEE system and respect reservations made by other Member States. Member States facing budgetary problems would be more than happy to tax benefits of European migrants under their income tax codes that were fully exempt by other Member States. Given the budgetary implications, Member States are unlikely to agree upon such a fully harmonized system on the European level.

Apart from its broader acceptance, the EET system seems to be a better choice as it is in line with the 'ability-to-pay' principle. The EET system ensures that PEPP holders are not taxed during the accumulation phase to ensure that they have a stable income upon retirement. The

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<sup>426</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 18.

<sup>427</sup> Cf. D. Kamin, *Getting Americans to Save: In Defense of (Reformed) Tax Incentives*, <https://ssrn.com/abstract=2865587> (accessed 14 January 2017).

<sup>428</sup> G. Staats, *Personal Pensions in the EU*, 321, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>429</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 142 (2007).

<sup>430</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 142 (2007).

<sup>431</sup> Cf. J. Schwartz, *Rethinking 401(K)s (March 5, 2011)*, *Harvard Journal on Legislation*, <https://ssrn.com/abstract=1817856> (accessed 14 January 2017).

idea is that PEPP holders will be taxed at the moment their benefits are being paid out to ensure income smoothing of PEPP holders.<sup>432</sup>

Governments in the short term facilitate the investment in PEPPs but providing such a tax deferral would lead to extra tax revenues in a later stage.<sup>433</sup> Deferred taxation, however, leads to complex legislation and high costs. Similar as for EEE systems, the EET system incentivizes high earners to disproportionately make advantage of the system. For this reason, most Member States employing an EET system have requirements in place for tax deductibility of contributions that vary from Member State to Member State and are also often limited to a certain level of income or to a fixed amount.<sup>434</sup> To ensure that the EET system is not abused, the EET system should be based upon the scope of the PEPP initiative and Member States could consider a system of ‘compensating layers’ or ‘matching contributions’.

#### 6.2.1.2 Tax Scope: PEPP Definition

To ensure that the EET system is not abused, it needs to be defined what type of products fall within the scope of a possible EET tax relief provided.

Existing national tax regimes applicable to personal pensions apply different assessment criteria to determine whether a certain personal pension product falls within the scope of the tax relief provided at national level.<sup>435</sup> There are various policy options that could be considered. First, the scope could be left over to individual Member States. The advantage of this option is that there is a level playing field between the features of national PPPs and PEPPs on the basis of which tax relief is being provided. Second, the scope could be determined on the EEA level. This second option is preferable as tax neutrality does not impede the functioning of the PEPP product passport. Leaving the scope to be determined on the national level would lead to a malfunctioning of the European passport as it creates tax distortions between the type of PEPPs and the Member States in which tax relief is to be obtained by consumers for certain PEPPs.

Tax distortions resulting from differences in the scope of the AIFMD/UCITS V and the scope of the tax regime applying to AIFs/UCITS shows that tax neutrality for the future PEPP initiative is of the essence. In the Netherlands, AIFs and UCITS, depending upon the legal form and assets invested in, may be tax transparent<sup>436</sup>, subject to corporate tax or benefit from the ‘Fiscal Investment Institution’<sup>437</sup> and the ‘Exempt Investment Institution’<sup>438</sup> exemptions.<sup>439</sup>

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<sup>432</sup> G. Staats, *Personal Pensions in the EU*, 226, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>433</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 142 (2007).

<sup>434</sup> European Insurance and Occupational Pensions Authority, *EIOPA’s advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

<sup>435</sup> European Commission, *Working Party IV – Direct Taxation – Discussion Paper Tax Aspects of (Pan-European) Personal Pension Products*, FISMA.D.4., 22 February 2017, 9-11.

<sup>436</sup> For example tax transparent limited partnerships: Dutch Fund and Asset Management Association/EY, *Investment Funds in the Netherlands*, [http://www.dufas.nl/site/assets/files/1304/rapport\\_ifitn-ey-dufas.pdf](http://www.dufas.nl/site/assets/files/1304/rapport_ifitn-ey-dufas.pdf) (accessed 14 January 2017).

<sup>437</sup> An investment entity with this status is subject to Dutch corporate tax at a rate of 0%.

<sup>438</sup> This regime provides for an exemption from Dutch corporate income tax and dividend withholding tax.



Applying different criteria for tax purposes than the scope of the AIFMD and UCITS V has led to a Dutch fund industry in which only closed-end AIFs flourish.<sup>440</sup> To the contrary, Liechtenstein, for example, applies tax transparency to all AIFs/UCITS.<sup>441</sup> A future possible tax regime for PEPPs based upon the EET principle would, thus, need to be based upon the PEPP definition under regulatory law in order to prevent tax distortions and optimally make use of the PEPP product passport.

### 6.2.1.3 The Compensating Layer: A Solution for Social Desirability?

PEPPs are third-pillar pension products that are intended to be invested in to overcome the ‘pensions gap’. An EET tax regime for PEPPs, however, raises questions from a social desirability point of view. Typically, people investing in third-pillar pension products are higher-income earners as lower-income earners fully consume and save to a certain degree to satisfy their consumption needs. Any tax system targeting merely high-income earners would not only be questionable from a fairness point of view but also would inefficiently use society’s resources.<sup>442</sup> Currently, many Member States, including Sweden and the UK, limit the tax deductibility of contributions made to third-pillar pension products to solve this issue. A more efficient use of taxation would be to implement a ‘compensating layer’ to any taxation regime governing the PEPP.<sup>443</sup> The ‘compensating layer’ idea is based upon income that an individual receives upon retirement from all three pillars. The taxation of contributions, investment income and benefits for third-pillar retirement products in a system based upon a compensating layer depends upon the expected retirement income in the first and second-pillar that an individual will receive upon retirement.<sup>444</sup> Such a system targets government resources of those with lesser means.<sup>445</sup>

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<sup>439</sup> See for an overview: Dutch Fund and Asset Management Association/EY, *Investment Funds in the Netherlands*, [http://www.dufas.nl/site/assets/files/1304/rapport\\_ifitn-ey-dufas.pdf](http://www.dufas.nl/site/assets/files/1304/rapport_ifitn-ey-dufas.pdf) (accessed 14 January 2017).

<sup>440</sup> S.N. Hooghiemstra, *The AIFMD’s Transposition in the Netherlands* (D. Zetzsche ed, Kluwer 2015).

<sup>441</sup> S.N. Hooghiemstra & D. Litwin, *The Liechtenstein 2011 UCITS Law Opens New Opportunities for Collective Investment Vehicles*, <https://my.uni.li/Portals/0/docs/fdl/Liechtenstein%202011%20UCITS%20Law.pdf> (accessed 14 January 2017).

See for UCITS: Art. 172 Loi du 17 décembre 2010 concernant les organismes de placement collectif; See for AIFs :

art. 214 Loi du 12 juillet 2013 relative aux gestionnaires de fonds d’investissement alternatifs.

<sup>442</sup> J. Schwartz, *Rethinking 401(K)s*, 49 *Harvard Journal on Legislation* 1 (2011), 21, <https://ssrn.com/abstract=1817856> (accessed 13 January 2017); J. Le Blanc, *The third pillar in Europe: institutional factors and individual Decisions*, Discussion Paper, Series 1: Economic Studies, No 09/2011, Deutsche Bundesbank; P. Antolin, A. de Serres, C. de la Maisonnette, *Long-Term Budgetary Implications of Tax-Favoured Retirement Plans*, OECD Economics Department Working Papers No 393, 2004.

<sup>443</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 *EC Tax Review* 142 (2007).

<sup>444</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 *EC Tax Review* 142 (2007).

<sup>445</sup> J. Schwartz, *Rethinking 401(K)s*, 49 *Harvard Journal on Legislation* 1 (2011), 22, <https://ssrn.com/abstract=1817856> (accessed 13 January 2017).



An example might clarify this<sup>446</sup>. A worker is paid a salary EUR 50,000; they are entitled to a state pension of EUR 10,000 upon reaching the age of 65. The standard has been set at 70% of a worker's last-earned salary, that is, 70% of EUR 50,000  $\frac{1}{4}$  EUR 35,000. This worker will have the option to accrue EUR 25,000 in pension in the second pillar and/or the third pillar under tax-efficient conditions. If the worker has the prospect of accruing EUR 15,000 in pension benefits in the second pillar, they are still eligible for tax relief on EUR 10,000 in the third pillar. And if this person does not accrue any second pillar pension (for instance because they came to be self-employed), their tax relief will be EUR 25,000 in the third pillar. This effectively makes the three pension pillars communicating vessels. The Dutch model partly takes this form. Tax relief is granted in the third pillar if minimal or no pension benefits are being accrued in the second pillar. The scale of the tax relief is not such, however, that a retirement provision can always be supplemented to 70% of a person's income.

The criticism of Staats on this idea is that tax relief for third-pillar pensions is solely dependable upon the total pension income from the first and second pillar and that third-pillar pensions cannot substitute first and second pillar pensions.<sup>447</sup>

#### 6.2.1.4 Matching Contributions as a Better Alternative?

Under ordinary EET systems, tax incentives are usually provided by means of tax-deductible contributions. Matching contributions have proven to be a very effective alternative for tax-deductible contributions for middle- and low- income groups.<sup>448</sup> Matching contributions are quite simple. Instead of tax-deferral on contributions, taxpayers receive under such a system tax credits that can reduce the tax owed to a net payment to the taxpayer.<sup>449</sup> For instance, a Member State could determine that for every €1.80 invested in PEPPs, a tax payer receives a 'matching' €1 from the government as a tax credit up to a certain cap. Substituting tax relief on contributions by matching contributions ensures that lower incomes benefit more than under regular EET systems. Under a matching contributions systems, higher income groups have to pay taxes against the highest tax bracket and their deduction are limited.<sup>450</sup> The negative effects of paying this effect are mitigated by matched contributions. This system, however, allows also low income groups to benefit from saving for retirement.<sup>451</sup>

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<sup>446</sup> Taken from: B. Starink & H. Van Meerten, *Cross-border obstacles and solutions for pan-European pensions*, 1 EC Tax Review 30 (2011).

<sup>447</sup> G. Staats, *Personal Pensions in the EU*, 309, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>448</sup> G. Staats, *Personal Pensions in the EU*, 220, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>449</sup> G. Staats, *Personal Pensions in the EU*, 226, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>450</sup> Commission on Taxation, *Report 2009*, Part 10, Tax Incentives for Retirement Savings, Stationery Office, Dublin (2009); G. Staats, *Personal Pensions in the EU*, 225, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>451</sup> P. Antolin & E. Lopez Ponton, *The impact of tax incentives on retirement savings: a literature review*, OECD, Private Pension System: developments and issues conference proceedings of the OECD/IOPS Global Private

### 6.2.2. A Solution for the ‘Pensionista’ Problem?

The broad acceptance of the EET principle<sup>452</sup> means that the potential difficulties of emigration have to be considered. Upon emigration of a resident the Member State that allowed a deduction of contributions or granted another tax incentive will lose its tax claim towards the accumulated retirement contributions.<sup>453</sup> This is the result of most double tax conventions that stipulate that the state of residence has the right to tax personal pensions.<sup>454</sup> For Member States that are ‘pension-exporting’ states the ‘pensionista problem’ is of particular relevance as tax deferral granted for personal pensions is based upon the idea that taxpayers pay taxes in the same Member State as that they build up their pension.<sup>455</sup> Leaving the ‘pensionista problem’<sup>456</sup> unresolved would mean that the ‘pension-exporting’ Member States would be reluctant to grant a tax deferred regime for investing in PEPPs at all. This would put the PEPP initiative at a competitive disadvantage compared to national third-pillar pension products that do receive tax-facilitation. Possible (multilateral, bilateral or unilateral) solutions that take into account European and international tax law would need to be considered.

#### 6.2.2.1 Tax Treaty Solutions

Double (non) taxation can be resolved by a multilateral tax treaty or bilateral tax treaties to arrange source state taxation so that taxation rights are being maintained also after emigration of taxpayers.

Jeck has suggested a multilateral tax treaty in which source states would be granted tax rights for a specific period of time and after the elapse of this time the other Member State is granted

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Pensions Forum (2008), 81; G. Staats, *Personal Pensions in the EU*, 228, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>452</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 19, 20; G. Staats, *Personal Pensions in the EU*, 228, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>453</sup> B. Starink, *Belastingheffing over particulierpensioen en overheidspensioen in grensoverschrijdende situaties*, 41-63, [https://pure.uvt.nl/portal/files/5672783/dissertatie\\_Bastiaan\\_Starink.pdf](https://pure.uvt.nl/portal/files/5672783/dissertatie_Bastiaan_Starink.pdf) (accessed 14 January 2017); G. Staats, *Personal Pensions in the EU*, 228, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>454</sup> G. Staats, *Personal Pensions in the EU*, 228, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>455</sup> D. Wellisch, *Internationaler Vergleich der steuerrechtlichen Forderung von Altersvorsorgeaufwendungen und deren Besteuerung bei Wegzug des Berechtigten ins Ausland*, Monatsbericht des BMF 2008

<sup>456</sup> See for the ongoing and increasing development of the ‘pensionista problem’ in the Germany: G. Staats, *Personal Pensions in the EU*, 229-231, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

the right to tax.<sup>457</sup> At the same time, it is broadly recognized in academia that this solution would be difficult to achieve.<sup>458</sup> A good alternative would be to opt for the same source taxation solution on the bilateral level. This solution could be, for instance, embedded in the protocol of existing tax treaties to change the right of taxation related to personal pensions.<sup>459</sup> The main problem to both the multilateral and bilateral tax treaty solution is that the ‘pension-importing’ countries would be unwilling to give up residence-based taxation, whereas the ‘pension-exporting’ countries would be in favour of (limited) source state taxation.<sup>460</sup>

#### 6.2.2.2. The Danish Double (non) Taxation Solution

During the Danish EU Presidency in 2002, another option for multilateral relief to avoid double (non) taxation on the EU level was being proposed.<sup>461</sup> The idea was that, after emigration, the residence state should not tax benefits to the extent that no tax deduction for contribution had been allowed in the source Member State.<sup>462</sup> If the source state would tax benefits at source, the residence Member State, in absence of a tax treaty, would need to avoid double taxation by crediting the tax against the tax of the resident Member State.<sup>463</sup> This system unilaterally introduced in Denmark and Sweden, however, could lead to double non-taxation.<sup>464</sup> For that purpose, it was suggested that if the Member State of residence is a TEE state and the Member State of source employs a EET system that benefits would be taxed as employment income instead.<sup>465</sup> Again, this system would be hard to achieve on the European level. Member States could, however, unilaterally apply it, for instance, in situations where a tax treaty is not in place.

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<sup>457</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 20; T. Jeck, *Die Riester-Rente: vereinbar mit EU-Recht?*, CEP Studie Centrum für Europäische Politik (2009), 13.

<sup>458</sup> T. Jeck, *Die Riester-Rente: vereinbar mit EU-Recht?*, CEP Studie Centrum für Europäische Politik (2009), 13; D. Wellisch, S. Lenz, K. Thiele, and R. Gahl, *Besteuerung der Altersvorsorge, Ein internationaler Vergleich* 105 (Nomos 2008).

<sup>459</sup> E. Kemmeren, *Pensions (Article 18 OECD Model Convention)* (M. Lang, P. Pistone, J. Schuch & C. Staringer eds. Kluwer 2008); G. Staats, *Personal Pensions in the EU*, 232, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>460</sup> A.M. Williams & T. Wames, *A Place in the Sun. International Retirement Migration from Northern to Southern Europe*, 4(2) *European Urban and Regional Studies* 115–34 (1997).

<sup>461</sup> Council of the European Union, *Presidency Note - Taxation of occupational pensions*, 19 November 2002, 14508/02, 6–9.

<sup>462</sup> G. Staats, *Personal Pensions in the EU*, 235, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>463</sup> G. Staats, *Personal Pensions in the EU*, 235, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>464</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 19.

<sup>465</sup> G. Staats, *Personal Pensions in the EU*, 235, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

### 6.2.2.3. The Clearing System as a Solution

In his Phd, De Greef has proposed a bilateral or multilateral ‘clearing system’ as a potential solution. The bilateral ‘macro-clearing system’ proposed would be that tax claims over accrued pension rights would be, on a per taxpayer basis, ceded to the member State of residence.<sup>466</sup> Claims would, thus, be settled on a bilateral basis having as an advantage that taxpayers would not face exit taxes. Another variant proposed by De Greef is to introduce this system based upon a European legislative instrument on a multilateral basis (‘macro-clearing’). This would imply that claims would be settled over the accrued pension rights on an annual and pro rata basis involving a fictitious tax percentage.<sup>467</sup> Both bilateral and multilateral clearing systems would have an advantage that Member States providing for tax deferral would collect taxes even if the tax payer does not retire in that Member State. The system is too complex to execute and would have to rely upon modern technology to be applied in practice.<sup>468</sup>

### 6.2.2.4. Conclusion

The renegotiation of tax treaties would be the solution of the least resistance and fitting in the tax treaty negotiating policy of ongoing tendency of ‘pension-exporting’ Member States. ‘Pension-importing’ Member States would, however, need to agree upon renegotiation in order to avoid double (non) taxation as, especially, double taxation would prevent migrants from migrating and ‘pension-exporting’ Member States from extending their national EET systems to PEPP in the first place.

### 6.2.3. Dealing with the Co-Existence of different Systems

The difficulty of harmonizing direct taxation on the European level leaves us to think about a practical solution for the case that no harmonization will be pursued for the taxation of PEPPs on the European level. Both the product passport and the migration of PEPP holders poses taxation challenges for PEPP providers. EFAMA, based upon the European Commission Tax Communication<sup>469</sup>, proposed that the ‘compartments solution’ could be applied to PEPPs for overcoming these taxation hurdles.<sup>470</sup> The idea is that PEPP providers establish sub-accounts attached to a general PEPP main account that are ‘compartments’ complying with the

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<sup>466</sup> R. De Greef, *Fiscale Pensioenbelemmeringen in de gemeenschappelijke markt* 308 (SDU 2004)

<sup>467</sup> R. De Greef, *Fiscale Pensioenbelemmeringen in de gemeenschappelijke markt* 284, 285 (SDU 2004; R. de Greef, *EU Policy for lifting pension tax obstacles does not work*, 4 EU Tax Review 202 (2005).

<sup>468</sup> L. Roos, *Pensioen en werknemersmobiliteit in de EU, Fiscale en juridische knelpunten*, Tilburg University, Brochures Toekomstvoorzieningen, 2006, 104-106.

<sup>469</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 16-18.

<sup>470</sup> European Fund and Asset Management Association, *Towards a Single Market for European Personal Pensions: Building Blocks for an EU legislation*, March 2015, 18, [https://www.efama.org/Publications/Public/EFAMA%20\\_EPP\\_Report\\_FINAL4March2015%29.pdf](https://www.efama.org/Publications/Public/EFAMA%20_EPP_Report_FINAL4March2015%29.pdf) (accessed 14 January 2017).

requirements of the tax regulations of the Member State where the PEPP holder is a resident.<sup>471</sup> If a PEPP holder is emigrating to another Member State and the PEPP provider of the PEPP currently invested in offers PEPPs in that Member State, the PEPP holder may continue to pay contributions to the same PEPP investment option previously invested in, but to a different sub-account.<sup>472</sup> It is, however, possible that the PEPP provider has opted not to offer the PEPP on the basis of the PEPP product passport in the new Member State of residence. In that case, the PEPP holder would have to invest in a PEPP being offered in that Member State and the accrued contributions in his PEPP account in the migrating Member State would be blocked until his retirement.<sup>473</sup> Upon retirement, the PEPP holder receives his benefits from each 'compartment' in accordance with the rules on payment and collection of tax applicable in the Member State of residence.

### 6.3. Conclusion

Various types of tax hurdles/obstacles have been identified to the cross-border provision of PEPPs, including tax discrimination, system diversity and the 'pensionista problem'.<sup>474</sup> These three problems are not necessarily a hurdle/problem by itself but they are also strongly interconnected. The European Commission and various interest groups have expressed their concern that tax obstacles could prevent the creation of an effective single market for PEPPs.<sup>475</sup> Over the past decades, the CJEU has mostly eradicated tax discrimination in its case law.<sup>476</sup> Nevertheless, problems related to system diversity and 'pensionista problem' remain. In these areas, differences between the taxation systems of Member States related to the deductibility

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<sup>471</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 17.

<sup>472</sup> European Fund and Asset Management Association, *Towards a Single Market for European Personal Pensions: Building Blocks for an EU legislation*, March 2015, 18, [https://www.efama.org/Publications/Public/EFAMA%20\\_EPP\\_Report\\_FINAL4March2015%29.pdf](https://www.efama.org/Publications/Public/EFAMA%20_EPP_Report_FINAL4March2015%29.pdf) (accessed 14 January 2017).

<sup>473</sup> European Fund and Asset Management Association, *Towards a Single Market for European Personal Pensions: Building Blocks for an EU legislation*, March 2015, 18, [https://www.efama.org/Publications/Public/EFAMA%20\\_EPP\\_Report\\_FINAL4March2015%29.pdf](https://www.efama.org/Publications/Public/EFAMA%20_EPP_Report_FINAL4March2015%29.pdf) (accessed 14 January 2017).

<sup>474</sup> Cf. B. Starink & H. Van Meerten, *Cross-border obstacles and solutions for pan-European pensions*, 1 EC Tax Review 30 (2011); H. Van Meerten & P. Borsjé, *A European Pensions Union*, National Bank of Slovakia, Series 2014, May, 5, 22, <https://ssrn.com/abstract=2425478> (accessed 28 October 2016).

<sup>475</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 37.

<sup>476</sup> P. Schonewille, *To what extent is tax still an issue for IORPS?*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ipe\\_sep2005.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ipe_sep2005.pdf) (accessed 13 January 2017); P. Schonewille, *The elimination of tax obstacles to pan-European pension funds: An overview*, [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/occ\\_pen\\_article3.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/occ_pen_article3.pdf) (accessed 13 January 2017).



of contributions and the taxation of benefits could possibly pose a problem for PEPP holders.<sup>477</sup> Currently, some Member States do not or hardly facilitate third-pillar private pensions by means of taxation, whereas other Member States allow deductions with the maximum deduction of contributions that applies to contributions across all three pillars.<sup>478</sup> There are even Member States that only allow deductions of contributions if there is a ‘pension gap’.<sup>479</sup> The Member States that do provide tax incentives mostly apply the EET system.<sup>480</sup> Broad acceptance of the EET system and extending existing systems to PEPPs would encourage pension savings. Tax deferral has proven to be an effective incentive for taxpayers to save for retirement. To encourage PEPP investments, Member States could consider to apply the principle of ‘compensating layers’ or substitute tax relief by a matching contributions system. Extending the EET system to all Member States would eradicate most, but not all problems. EET systems are complicated and may lead to double(non)taxation in migration cases. Politically it is hardly feasible to harmonize the direct taxation field. For this reason, the sole realistic remedy seems to be a renegotiating of tax treaties between the Member States concerned. PEPP providers may deal with taxation issues by creating sub-accounts linked to main accounts. This solution is, however, limited to their PEPP product passport. If a PEPP provider does not offer PEPPs in the Member State where a PEPP holder is migrating to, the provider is forced to ‘lock-in’ the account. Even if tax obstacles are not remedied on the European level, the introduction of the PEPP would still lead to a single market for PEPPs as it facilitates the cross-border supply of PEPPs and enhances consumer choice and reduces costs.<sup>481</sup>

## 7 Comparative Research

Untill now, this Report focused on the development of a PEPP regulatory framework from a regulatory and tax perspective. A review of current PPP regimes in Sweden, the UK and the US, however, seems to indicate that the regulatory and tax regime of PPP regimes, on the one hand, and second- and third-pillar PPP regimes are more closely aligned than so far has been assumed. Also the Dutch PPI IORP will shortly be discussed.

### 7.1 Sweden - Individual Pension Savings Accounts

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<sup>477</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 18.

<sup>478</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 144 (2007).

<sup>479</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 144 (2007).

<sup>480</sup> European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 59.

<sup>481</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 38.

A good example of a national ‘PEPP-like product’ is to be found in Sweden in the form of IPS (Individuellt pensionssparande; Individual Pension Savings).<sup>482</sup> An IPS is based upon a contract or agreement between an individual and a provider setting up an IPS account.<sup>483</sup> Providers have to be investment firms that are authorized to operate IPS accounts by the Swedish Supervisory Authority.<sup>484</sup>

Individual pension savings (IPS) allow people to invest in a broad range of investments. Eligible investments include deposits<sup>485</sup>, shares in AIFs/UCITS<sup>486</sup> and other securities<sup>487</sup>. These other securities must be traded at a regulated market or an equivalent market outside the EEA.<sup>488</sup> Despite of the wide range of investments about 90% of the total IPS assets are AIF/UCITS units.<sup>489</sup> IPS has a retirement objective and, therefore, the investment cannot be withdrawn until retirement.<sup>490</sup> Instead, investors do have the right to switch providers.<sup>491</sup> Furthermore, IPS providers are required to abide by comprehensive disclosure requirements including an annual report, costs, the investor’s transaction records and an overview of the assets.<sup>492</sup>

Prior to 2015, the Swedish IPS has proven to be an efficient third-pillar pension savings schemes with low costs for investors that benefitted from an ETT tax regime that fuelled savings.<sup>493</sup> IPS contributions were tax deductible up to 12000 SEK each year for retirement, whereas, similar to traditional and unit linked insurances, earnings and distributions were

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<sup>482</sup> European Fund and Asset Management Association, *The European Personal Pension Account*, May 2005, 31, [https://www.efama.org/Publications/Public/Long-Term\\_Savings\\_and\\_Pension\\_Steering\\_Committee/eppareport.pdf](https://www.efama.org/Publications/Public/Long-Term_Savings_and_Pension_Steering_Committee/eppareport.pdf) (accessed 14 January 2017).

<sup>483</sup> Chapter 1 §1 Lag (1993:931) om individuellt pensionssparande.

<sup>484</sup> Chapter 2 §3 Lag (1993:931) om individuellt pensionssparande.

<sup>485</sup> Chapter 2 §1(1), §2 Lag (1993:931) om individuellt pensionssparande ; See also SFS 2013:566 Lag om ändring i lagen (1993:931) om individuellt pensionssparande

<sup>486</sup> Chapter 2 §1(2) Lag (1993:931) om individuellt pensionssparande; See also SFS 2013:566 Lag om ändring i lagen (1993:931) om individuellt pensionssparande.

<sup>487</sup> Chapter 2 §1(3), §4 Lag (1993:931) om individuellt pensionssparande.

<sup>488</sup> Chapter 2 §4 Lag (1993:931) om individuellt pensionssparande ; See also SFS 2013:566 Lag om ändring i lagen (1993:931) om individuellt pensionssparande.

<sup>489</sup> European Fund and Asset Management Association, *The European Personal Pension Account*, May 2005, 32, [https://www.efama.org/Publications/Public/Long-Term\\_Savings\\_and\\_Pension\\_Steering\\_Committee/eppareport.pdf](https://www.efama.org/Publications/Public/Long-Term_Savings_and_Pension_Steering_Committee/eppareport.pdf) (accessed 14 January 2017).

<sup>490</sup> Chapter 2 §1(3) Lag (1993:931) om individuellt pensionssparande ; See also SFS 2013:566 Lag om ändring i lagen (1993:931) om individuellt pensionssparande.

<sup>491</sup> Chapter 3 §9 Lag (1993:931) om individuellt pensionssparande.

<sup>492</sup> Chapter 3 §10-12 Lag (1993:931) om individuellt pensionssparande; European Fund and Asset Management Association, *The European Personal Pension Account*, May 2005, 32, [https://www.efama.org/Publications/Public/Long-Term\\_Savings\\_and\\_Pension\\_Steering\\_Committee/eppareport.pdf](https://www.efama.org/Publications/Public/Long-Term_Savings_and_Pension_Steering_Committee/eppareport.pdf) (accessed 14 January 2017).

<sup>493</sup> European Fund and Asset Management Association, *The European Personal Pension Account*, May 2005, 32, [https://www.efama.org/Publications/Public/Long-Term\\_Savings\\_and\\_Pension\\_Steering\\_Committee/eppareport.pdf](https://www.efama.org/Publications/Public/Long-Term_Savings_and_Pension_Steering_Committee/eppareport.pdf) (accessed 14 January 2017).



taxed.<sup>494</sup> By 2015 this amount was reduced to 1800 SEK and in 2016 this tax deduction was reduced to zero for most people.<sup>495</sup> People that do not build up pension benefits through their employers and self-employed people, however, may continue to deduct their contributions up to 1800 SEK a year.<sup>496</sup> Ordinary people that continue to invest in IPS after 2015 that cannot deduct contributions for tax purposes are subject to economic double taxation<sup>497</sup> as they first pay income tax over their IPS contributions, whereas the accumulated IPS assets earnings and distributions are also taxed. De facto, the Swedish government, thus, trusts upon its first and second pillar pension systems for building up adequate retirement benefits. People wishing to build up additional third-pillar income will need other ways to invest for retirement.

The investment savings account ('*investeringssparkonto*'; ISK) that was introduced in 2012 has accounted for the biggest share of Swedish household savings in funds over the past years.<sup>498</sup>

The ISK is, however, not comparable to IPS nor PEPPs as they do not have a retirement objective but were introduced as a 'tax wrapper'. De facto, the ISK is an investment account in which the assets held are subjected to a flat-rate tax instead of the complicated Swedish taxation applying to other investments.<sup>499</sup> Its introduction had as its purpose to simplify the taxation of certain types of investments held through this account to avoid tax planning and evasion.<sup>500</sup> Financial instruments listed on a regulated market and AIFs/UCITS may be held in a ISK.<sup>501</sup> Capital gains and dividends are not taxed within the ISK. Instead a standard income,

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<sup>494</sup> Skatteverkets pressmeddelande, Avdrag för pensionssparande avskaffas vid årsskiftet, 18 December 2015, <http://www.skatteverket.se/omoss/press/pressmeddelanden/riks/2015/2015/avdragforpensionssparandeavskaffasvidarsskiftet.5.3810a01c150939e893ff7b8.html> (accessed 14 January 2017).

<sup>495</sup> Skatteverkets pressmeddelande, Avdrag för pensionssparande avskaffas vid årsskiftet, 18 December 2015, <http://www.skatteverket.se/omoss/press/pressmeddelanden/riks/2015/2015/avdragforpensionssparandeavskaffasvidarsskiftet.5.3810a01c150939e893ff7b8.html> (accessed 14 January 2017).

<sup>496</sup> Skatteverkets pressmeddelande, Avdrag för pensionssparande avskaffas vid årsskiftet, 18 December 2015, <http://www.skatteverket.se/omoss/press/pressmeddelanden/riks/2015/2015/avdragforpensionssparandeavskaffasvidarsskiftet.5.3810a01c150939e893ff7b8.html> (accessed 14 January 2017).

<sup>497</sup> M. Rasmussen, *International Double Taxation 2* (Kluwer 2011).

<sup>498</sup> See <http://www.investmenteurope.net/regions/swedendenmarkfinlandnorway/swedish-investment-savings-accounts-take-top-share-fund-sales/> (accessed 14 January 2017).

<sup>499</sup> Finansinspektionen, *Yttrande angående Schablonbeskattat investeringsspar-konto och ändrad beskattning av kapitalförsäkring*, FI 2010/5534 (2010), <https://www.skatteverket.se/rattsinformation/remissvar/remissvar2011/13180840810112.5.70ac421612e2a997f85800014804.html> (accessed 14 January 2017); Skatteverket, *Yttrande angående Schablonbeskattat investeringsspar-konto och ändrad beskattning av kapitalförsäkring*, 131 808408-10/112 (2011), <https://www.skatteverket.se/rattsinformation/remissvar/remissvar2011/13180840810112.5.70ac421612e2a997f85800014804.html> (accessed 14 January 2017).

<sup>500</sup> Finansdepartementet, *Schablonbeskattat investeringssparkonto och ändrad beskattning av kapitalförsäkring*, (2010), 2, <http://www.regeringen.se/rapporter/2010/12/schablonbeskattat-investeringssparkonto-och-andrad-beskattning-av-kapitalforsakring/> (accessed 14 January 2017); Finansdepartementet, *Investeringssparkonto, Tilläggspromemoria* (2011), <http://www.regeringen.se/49bb21/contentassets/a583ad4ef7524e97b71f502eb9d137d8/investeringssparkonto-tillaggspromemoria> (accessed 14 January 2017).

<sup>501</sup> § 6 Lag (2011:1268) om investeringssparkonto.

based on the government bond yield of the previous year, shall be levied as a capital gain.<sup>502</sup> Withdrawals from the ISK are, however, not taxed. The ISK, thus, cannot be seen as a viable alternative for the IPS as it is, de facto, taxed and does not eliminate the economic double taxation faced by IPS investors.

## **7.2 UK – Personal Pensions**

In the UK personal pensions were introduced to offer an alternative for people without access to an occupational scheme or people that change jobs frequently.<sup>503</sup> The UK offers tax relief for personal pensions to encourage savings.

There are different types of personal pension. They include:

- Stakeholder Pension Schemes
- Self-Invested Personal Pension (SIPP)
- Group Personal Pension/Group stakeholder pension scheme/Group SIPPs

In the UK, (self-invested) personal pension schemes and stakeholder pension schemes are the most important personal pensions.

### **7.2.1 Stakeholder Pension schemes**

The Welfare Reform and Pensions Act 1999 and the Finance Act 2000 introduced stakeholder pension schemes in the UK on 6 April 2001.<sup>504</sup> The introduction of stakeholder pension schemes had as its objective to encourage pension savings for retirement, in particular, for employees with low and moderate incomes.<sup>505</sup>

Stakeholder pensions are a form of defined contribution personal pension. Stakeholder pensions are individual contracts between members and the pension provider. The pension provider is often an insurance company or an investment platform, although there are also a number of other providers, including banks and building societies.<sup>506</sup> Stakeholder pensions are required to meet a number of conditions set out in legislation, including low and flexible minimum

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<sup>502</sup> Swedish Investment Fund Association, *Taxation of Fund Savings*, July 2012, [http://fondbolagen.se/PageFiles/1944/Skatt\\_pa\\_fondsparande\\_eng%20rev%20juli%2012%20CG.pdf](http://fondbolagen.se/PageFiles/1944/Skatt_pa_fondsparande_eng%20rev%20juli%2012%20CG.pdf) (accessed 14 January 2017).

<sup>503</sup> G. Staats, *Personal Pensions in the EU*, 114, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>504</sup> The Stakeholder Pension Regulations 2000, Statutory Instruments, 2000 No. 1403, Pensions, 24<sup>th</sup> May 2000; House of Commons, *Stakeholder Pensions*, Research Paper 01/69 (2001).

<sup>505</sup> J.M. Samworth. *Understanding the implications of stakeholder pensions for occupational pension schemes*, 6 Pensions: An International Journal 11-21 (2000); G. Staats, *Personal Pensions in the EU*, 114, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>506</sup> See <http://www.pensionsadvisoryservice.org.uk/about-pensions/pensions-basics/contract-based-schemes/stakeholder-pension-schemes> (accessed 14 January 2017); J. Wilson, *Stakeholder pension schemes: The current state of play*, 5 Pensions: An International Journal 303-316 (2000); C. Emmerson & S. Tanner, *The government's proposals for stakeholder pensions*, Institute for Fiscal Studies (October 1999), <http://www.ifs.org.uk/bns/bn1.pdf> (accessed 14 January 2017).

contributions, capped charges and a default investment strategy for those that do not want to choose.<sup>507</sup> They are a flexible way to build up retirement income benefits, while benefiting from tax advantages.

Since October 2001 employers with five or more employees are required to provide access to a stakeholder pension scheme for their employees unless they offer a suitable alternative pension scheme.<sup>508</sup> Employees are, however, not obliged to participate. Stakeholder pensions are flexible and portable. Members may continue to contribute to the scheme if changing jobs, stopping working and if joining a new employer, they may decide to contribute to the scheme as well.<sup>509</sup> For people not having access to occupational pension, stakeholder pensions remain as easy and accessible.<sup>510</sup>

### **7.2.2 Self-Invested Personal Pension (SIPP)**

A self-invested personal pension (SIPP) is a type of personal pension plan that was introduced by the Finance Act 1989.<sup>511</sup> Similar as for PEPPs, they are an individual contract concluded by an individual and a pension provider. However, SIPPs offer much wider investment powers than are generally available for personal pensions and group personal pensions. SIPPs allow the individual pension holders to decide how the contributions are invested.<sup>512</sup> Due to the role that individuals play in SIPP investment decisions, the range of assets in which SIPPs may be invested are restricted by the HMRC requirements and the restrictions in the rules of the

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<sup>507</sup> <https://www.moneyadvice.service.org.uk/en/articles/stakeholder-pensions> (accessed 14 January 2017).; J.

Hayes, *Regulating stakeholder pensions*, 5 *Pensions: An International Journal* 195-199 (2000); I. Greenstreet.

*Stakeholder pensions – The compliance regime*, 8 *Pensions: An International Journal* 152-161 (2003); D. Blake, *The UK pension system: Key issues*, 8 *Pensions* 330 (2003).

<sup>508</sup> The Pensions Regulator, *Detailed guidance for employers 4 – Pension schemes: Pension schemes under the new employer duties*, <http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-4.pdf> (accessed 14 January 2017).

<sup>509</sup> Cf. I. Greenstreet. *How will the new requirements to facilitate access to stakeholder schemes affect employers?*, 5 *Pensions: An International Journal* 317-328 (2000).

<sup>510</sup> Other people are also able to contribute, and you can contribute to other people's personal pensions. For example, you could contribute to your spouse's or partner's personal pension, or even to a child's personal pension to allow them to start building up retirement benefits from an early age. See <http://www.pensionsadvisoryservice.org.uk/about-pensions/pensions-basics/contract-based-schemes/personal-pensions> (accessed 14 January 2017).

<sup>511</sup> See <http://www.pensionsadvisoryservice.org.uk/about-pensions/pensions-basics/contract-based-schemes/self-invested-personal-pensions-sipp>; G. Staats, *Personal Pensions in the EU*, 116, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>512</sup> Financial Services Authority, *The regulation of personal pension schemes including SIPPs*, CP 06/5, April 2006; Financial Services Authority, *The regulation of personal pension schemes including SIPPs: Feedback on CP06/5 and made text*, PS 06/7, September 2006; HM Treasury, *Proposed changes to the eligibility rules for establishing a pension scheme: consultation update*, 5 December 2005; HM Treasury, *Proposed changes to the eligibility rules for establishing a pension scheme – A consultation document*, September 2005, <http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/media/093/EC/pensioncondoc300905.pdf> (accessed 14 January 2017).

scheme.<sup>513</sup> A wide range of assets may be invested in, including, amongst others, quoted UK and overseas stocks and shares, unlisted shares, collective investments (such as OEICs and unit trusts) and investment trusts.<sup>514</sup> Employers may contribute to SIPPs. They are, however, not obliged to do so. SIPPs are furthermore subject to the general drawing pension benefits and tax regime for UK personal pension schemes.

### **7.2.3 Group Personal Pension/Group stakeholder pension scheme/Group SIPPs**

Group Personal Pension Plans, Group Stakeholder Pension Schemes and Group SIPPs are personal pension plans, stakeholder pension schemes and SIPPs that are provided by an employer for its employees.<sup>515</sup> Only the ‘group element’ is different compared to the underlying scheme. For instance, Group SIPPs offer much wider investment powers than Group Personal Pension Plans.<sup>516</sup> The role of employers in these ‘group schemes’ often results in lower costs compared to individual personal pension plans.<sup>517</sup> Group Pension Plans, however, are not the same as occupational pensions. Occupational pensions are regulated under a different set of legislation.<sup>518</sup>

### **7.2.4 UK Taxation: The ‘Compensating Layer’**

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<sup>513</sup> Financial Conduct Authority, *A guide for Self-Invested Personal Pensions (SIPP) operators*, 8 October 2013; <https://www.fca.org.uk/publication/finalised-guidance/fg13-08.pdf> (accessed 14 January 2017); D. Thurley, *Self-invested personal pensions (SIPP)*, House of Commons Library, 24 April 2013; FSA Press Release, *FSA proposes regime for SIPP and other personal pensions*, 4 April 2006; Financial Services Authority, *The regulation of personal pension schemes including SIPPs: Feedback on CP06/5 and made text*, FSA 06/7, September 2006; Financial Services Authority, *SIPP thematic review findings and guidance*, GC12/12, 23 October 2012; Financial Services Authority, *Self-Invested Personal Pensions (SIPP) operators. A report on the findings of a thematic review*, October 2012.

<sup>514</sup> B. Masters, L. Warwick-Ching & J. Cumbo, *New rules to protect Sipp investors*, Financial Times (23 November 2012); D. O’Loughlin, *Sipps trade body slams plans to base capital needs on assets*, FT adviser, 21 February 2013.

<sup>515</sup> See on ‘group pensions’: European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, Annex 1-3; European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 18.

<sup>516</sup> See <http://www.pensionsadvisoryservice.org.uk/about-pensions/pensions-basics/contract-based-schemes/self-invested-personal-pensions-sipp?moreInfo=1> (accessed 14 January 2017); G. Staats, *Personal Pensions in the EU*, 116, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>517</sup> <http://www.pensionsadvisoryservice.org.uk/about-pensions/pensions-basics/contract-based-schemes/personal-pensions?moreInfo=1> (accessed 14 January 2017).

<sup>518</sup> See European Insurance and Occupational Pensions Authority, *Discussion Paper on a possible EU-single market for personal pension products*, 16 May 2013, EIOPA/13/241, Annex 1-3; European Insurance and Occupational Pensions Authority, *Towards an EU-single market for personal pensions – An EIOPA Preliminary Report to COM*, February 2014, EIOPA-BoS-14/029, 18. ; See also G. Staats, *Personal Pensions in the EU*, 117, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

In the UK, an EET system is applied to pensions. The EET system is a ‘compensating layer’<sup>519</sup> as the tax limits of contributions (the annual and lifetime allowance) applies to occupational and personal pensions jointly.<sup>520</sup> In fact, no difference is being made between occupational and personal pensions at all.<sup>521</sup> Consequently, there is no restriction on the number of different (personal) pension schemes to join. The limits on the total amount of contributions that qualify for tax relief if contributing across multiple schemes apply to both. Personal pension schemes are, thus, flexible in providing additional retirement benefits.

### 7.2.5 Conclusion

The UK has different types of personal pensions including (Group) stakeholder pension schemes, (Group) SIPP and (Group) Personal Pension. For regulatory and tax purposes, the differences between the personal and occupational pensions in the UK are not clear-cut. Personal pension schemes may be invested in by employed, unemployed or self-employed people. In this regard, personal pensions that are ‘Group’ pensions are being provided by employers for their employees. Nevertheless, employers may agree with their employees to contribute to their personal stakeholder pension schemes or SIPPs. This nature is also reflected by the tax relief applying to contributions to all types of personal pension schemes.

## 7.3 US – 401(k) and IRA plans

The US has already gathered experience with ‘PEPP-like products’ over the past three decades. Both employer-sponsored 401(k) and third-pillar IRA plans were introduced to overcome problems related to pension funds and the resulting ‘pension gap’ that were faced in the US. An overview of the regulatory framework of 401(k) and IRA plans might show how the PEPP initiative might develop in the EEA.

### 7.3.1 401(k)

401(k) accounts are employer-sponsored tax-qualified defined-contribution retirement savings plans. 401(k) plans arose in the 1980s as an alternative for occupational pension funds. As a result of the high costs of those funds, employers started to offer 401(k)s. 401(k)s are defined contribution plans that are by far the most important plans in terms of assets and its assets grow year after year.<sup>522</sup> A 401(k) plan allows an employee to elect to have the employer contribute a portion of the employee’s wages to an individual account under the plan. Employers are legally not required to offer their employees 401(k)s. Many employers do offer to match a part of the

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<sup>519</sup> G. Dietvorst, *Proposal for a pension model with a compensating layer*, 3 EC Tax Review 142 (2007).

<sup>520</sup> G. Staats, *Personal Pensions in the EU*, 117, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>521</sup> G. Staats, *Personal Pensions in the EU*, 114, 115, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>522</sup> TIAA-CREF Institute, *Perspectives on Retirement System Reform for the 21st Century*, Policy Brief, December 2009; Internal Revenue Service, *Pension and Annuity Income*, Publication 575 (2016), <https://www.irs.gov/pub/irs-pdf/p575.pdf> (accessed 14 January 2017).



contributions of their employees.<sup>523</sup> Employers, for example, may agree to match 50% of an employee's contribution for a total of up to 3% of that employee's salary.<sup>524</sup> In terms of investments, employers, typically, appoint third parties, such as fund managers for the administration of the 401(k) plans. Depending upon the plan, employees may choose amongst a selection of investments in a variety of mutual funds or even a broader range of assets in a so-called brokerage window.<sup>525</sup>

Under the 'regular' 401(k) plans, retirement savings contributions are provided by an employer, deducted on a tax-deferred basis.<sup>526</sup> 401(k) plans allow employees to partly or fully fund their accounts with pre-tax or after-tax (Roth 401(k) accounts) contributions.<sup>527</sup> Employees opting for pre-tax contributions are not taxed on their contributions and investment returns until withdrawal. This option is chosen by employees that expect their retirement income to be taxed in a lower tax bracket than when the money was earned.<sup>528</sup> The Roth 401(k) accounts are subject to the same tax rules as Roth IRAs. Typically, this option is preferred by employees that do not expect their retirement income to be taxed in a lower tax bracket than when their money

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<sup>523</sup> Internal Revenue Service, *401(k) Plans*, <https://www.irs.gov/retirement-plans/401k-plans> (accessed 14 January 2017).

<sup>524</sup> Internal Revenue Service, *401(k) Plan Overview*, <https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview> (accessed 14 January 2017).

<sup>525</sup> US Government Accountability Office (GAO), *401(K) PLANS - Clearer Regulations Could Help Plan Sponsors Choose Investments for Participants*, GAO-15-578, August 2015, <http://www.gao.gov/products/GAO-15-578> (accessed 14 January 2017); A.J. Golly, *Understanding 401(k) Mechanics: A Look at How the Plans Operate*, <https://www.aaii.com/journal/article/understanding-401-k-mechanics-a-look-at-how-the-plans-operate> (accessed 14 January 2017); U.S. Department of Labor, *Fact Sheet: Default Investment Alternatives Under Participant-Directed Individual Account Plans*, September 2006, <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/default-investment-alternatives-under-participant-directed-individual-account-plans> (accessed 14 January 2017); See also O.S. Mitchell & S.P. Utkus, *Target-Date Funds in 401(k) Retirement Plans*, Pension Research Council Working Paper PRC WP2012 (2012); United States Department of Labour, *Regulation Relating To Qualified Default Investment Alternatives In Participant-Directed Individual Account Plans*, <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/fsQDIA.pdf> (accessed 14 January 2017).

<sup>526</sup> Cf. C. Marr, N. Frenz & C. Ching Huang, *Retirement Tax Incentives Are Ripe for Reform - Current Incentives Are Expensive, Inefficient, and Inequitable*, Center on Budget and Policy Priorities (2013), <http://www.cbpp.org/research/retirement-tax-incentives-are-ripe-for-reform> (accessed 14 January 2017); D. Kamin, *Getting Americans to Save: In Defense of (Reformed) Tax Incentives*, <https://ssrn.com/abstract=2865587> (accessed 14 January 2017).

<sup>527</sup> J. E. Buckley, *Comparison of Roth 401k, Roth IRA, and Traditional 401k Retirement Plans*, [http://www.401khelpcenter.com/dol/pr\\_dol\\_rothcomparisonchart.html#.WGpZbEaC7Qg](http://www.401khelpcenter.com/dol/pr_dol_rothcomparisonchart.html#.WGpZbEaC7Qg) (accessed 14 January 2017); J. Beshears, J.J. Choi, D. Laibson & B.C. Madrian, *Does Front-Loading Taxation Increase Savings? Evidence from Roth 401(k) Introductions*, Working Paper 20738 (2014), <http://www.nber.org/papers/w20738> (accessed 14 January 2017); S.M. Horan, *Choosing Between Tax-Advantaged Savings Accounts: A Reconciliation of Standardized Pre-tax and After-tax Frameworks*, 12 Financial Services Review 339-357 (2003).

<sup>528</sup> J. Schwartz, *Rethinking 401(K)s (March 5, 2011)*. *Harvard Journal on Legislation*, <https://ssrn.com/abstract=1817856> (accessed 14 January 2017).

was earned.<sup>529</sup> There are set limits each year with respect to how much an employee may contribute and withdrawals before the age of 59½ are penalized.<sup>530</sup>

There are several types of 401(k) plans available to employers, including traditional 401(k) plans, safe harbor 401(k) plans and SIMPLE 401(k) plans to which different rules apply but that operate in accordance with certain rules to obtain a tax-favored status.<sup>531</sup> The following is a brief overview of the three common sub-types of 401(k) plans.

### 7.3.1.1 Traditional 401(k) Plans

A traditional 401(k) plan is an employer-sponsored 401(k) plan that allows (eligible) employees<sup>532</sup> to contribute to a 401(k) plan on a tax-deferred basis through payroll deductions.<sup>533</sup> Many employers make so-called ‘matching contributions’ for those employees that choose to participate in a traditional 401(k) plan, i.e. employers may ‘match’ 50 cents to a dollar for every dollar that employees contribute to such a plan up to a certain limit of 3-6% of the employees’ salary.<sup>534</sup> Employers may, however, choose to opt for immediate (vesting) or to implement a ‘vesting schedule’. A ‘vesting schedule’ implies that employees obtain the legal right to keep the matching contributions made by an employer after a certain period of time working at the company.<sup>535</sup> Early leave or being fired by a company implies under a vesting schedule that the employer has the right to forfeit the matched funds. Vesting schedules, however, do not apply to the deferred contributions made by employees. These contributions cannot be forfeited. Contributions, matching funds and earnings are under traditional 401(k) plans taxed upon withdrawal.<sup>536</sup>

Traditional 401(k) plans have to meet certain non-discrimination requirements. The substantial tax benefits offered by the U.S. government are subject to the condition that company owners, key and highly-compensated employees do not benefit disproportionately from the 401(k) benefits compared to ordinary employees. For this purpose, 401(k) on an annual basis have to

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<sup>529</sup> Internal Revenue Service, *Designated Roth Accounts Under a 401(k) or 403(b)*, Plan Publication 4530 (Rev. 4-2012) - IRS.gov, <https://www.irs.gov/pub/irs-pdf/p4530.pdf> (accessed 14 January 2017).

<sup>530</sup> Internal Revenue Service, *Retirement Topics - 401(k) and Profit-Sharing Plan Contribution Limits*, <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-401k-and-profit-sharing-plan-contribution-limits> (accessed 14 January 2017).

<sup>531</sup> Internal Revenue Service, *401(k) Plan Overview*, <https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview> (accessed 14 January 2017).

<sup>532</sup> Eligible employees are employees that participate in a 401(k) plan.

<sup>533</sup> J. E. Buckley, *Comparison of Roth 401k, Roth IRA, and Traditional 401k Retirement Plans*, [http://www.401khelpcenter.com/dol/pr\\_dol\\_rothcomparisonchart.html#.WGpZbEaC7Qg](http://www.401khelpcenter.com/dol/pr_dol_rothcomparisonchart.html#.WGpZbEaC7Qg) (accessed 14 January 2017); Internal Revenue Service, *Employee Benefit Plans - Explanation No. 12 Section 401(k) Requirements*, <https://www.irs.gov/pub/irs-pdf/p7335.pdf> (accessed 14 January 2017).

<sup>534</sup> See for an explanation of ‘matching contributions’: G. Staats, *Personal Pensions in the EU*, 226, [https://pure.uvt.nl/portal/files/1567484/Staats\\_personal\\_29-01-2014.pdf](https://pure.uvt.nl/portal/files/1567484/Staats_personal_29-01-2014.pdf) (accessed 14 January 2017).

<sup>535</sup> Internal Revenue Service, *Retirement Topics – Vesting*, <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-vesting> (accessed 14 January 2017).

<sup>536</sup> J. Schwartz, *Rethinking 401(K)s* (March 5, 2011). *Harvard Journal on Legislation*, <https://ssrn.com/abstract=1817856> (accessed 14 January 2017).



comply with tests, such as the Actual Deferral Percentage (ADP), Actual Contribution Percentage (ACP) and top heavy tests.<sup>537</sup> These tests ascertain that deferred contributions and employer matching contributions stay within a specific contribution rate, as determined by the contribution rate of non-highly compensated employees to avoid discrimination in favour of highly compensated employees.<sup>538</sup>

### 7.3.1.2 Safe Harbor 401(k) Plans

The ‘safe harbor’ 401(k) plan is a popular retirement plan that are, in particular, used by small businesses. The plan is similar to the 401(k) plan but are under certain conditions exempt from the non-discrimination testing applying to elective deferrals and employer matching contributions under traditional 401(k) plans.<sup>539</sup> Typically, traditional 401(k) limits the amount that (small) business owners can contribute to their traditional ‘non-safe harbor plan’.<sup>540</sup> Safe Harbor 401(k) enable (small) business owners to maximize contributions to their own 401(k) accounts under the condition that a minimum contribution is being made on behalf of the employees.<sup>541</sup> 401(k) plans qualify as a ‘safe harbor plan’ if they satisfy certain contributions, vesting and notice requirements.

Employers are required to choose between two contribution options for 401(k) accounts that are fully vested and must be paid on a periodical basis.<sup>542</sup> Contributions may be employer matching contributions, limited to employees who defer, or employer contributions made on behalf of all eligible employees, regardless of whether they make elective deferrals. Employers opting in for the first option have to match 100% of the elective employee contributions (applying to both pre-tax and post-tax 401(k) contributions) on the first 4-6% of compensation of their employees, whereas employers opting for the latter have to contribute a (non-elective) contribution of 3% of compensation for all (eligible) employees.<sup>543</sup> In addition, safe harbor 401(k) plans are required to be fully vested. Employers may, thus, not impose any vesting schedule on matching contributions that are being made.<sup>544</sup> Finally, employers contributing to 401(k) plans must satisfy notice requirements that entail written information related to the

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<sup>537</sup> 26 CFR 1.401(a)(4)-1 - Nondiscrimination requirements of section 401(a)(4); Cf. Internal Revenue Service, *401(k) Plan Fix-It Guide - The plan failed the 401(k) ADP and ACP nondiscrimination tests*, <https://www.irs.gov/retirement-plans/401k-plan-fix-it-guide-the-plan-failed-the-401k-adp-and-acp-nondiscrimination-tests> (accessed 14 January 2017).

<sup>538</sup> U.S. Department of Labor, *Choosing a Retirement Solution for Your Small Business*, <https://www.irs.gov/pub/irs-pdf/p3998.pdf> (accessed 14 January 2017); U.S. Department of Labor’s Employee Benefits Security Administration (DOL/EBSA) & the Internal Revenue Service, *401(k) for Small Businesses*, <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/401kPlansSmallBusiness.pdf> (accessed 14 January 2017).

<sup>539</sup> 26 CFR 1.401(k)-3 - Safe harbor requirements.

<sup>540</sup> 26 CFR 1.401(k)-3 (b) and (c).

<sup>541</sup> 26 CFR 1.401(k)-3 (b).

<sup>542</sup> 26 CFR 1.401(k)-3 (c).

<sup>543</sup> 26 CFR 1.401(k)-3 (b) and (c).

<sup>544</sup> 26 CFR 1.401(k)-3 (a).

employee's rights and obligations under the plan that complies with certain content and timing requirements.<sup>545</sup> Safe harbor plans do not impose any requirements on the size of the employer and may be combined with other (employer-sponsored) retirement plans.<sup>546</sup>

### 7.3.1.3 SIMPLE 401(k) Plans

The SIMPLE 401(k) is a subset of the 401(k) plan that allow small business to offer cost-effective retirement benefit to their employees.<sup>547</sup> The SIMPLE 401(k) contains both features of a SIMPLE IRA and a traditional 401(k) plan.<sup>548</sup> Similar as to SIMPLE IRA plans, the plan may be used by small businesses with 100 or fewer employees.<sup>549</sup> SIMPLE 401(k) are exempted from the non-discrimination tests that apply to traditional 401(k) plans.<sup>550</sup> Employers are required to make contributions that are fully vested and are applying to employees that received at least \$5,000 in the preceding year.<sup>551</sup> Unlike other 401(k) plans, eligible employees may not receive any contributions or benefit accruals under any other plans offered by their employer.<sup>552</sup> Employees may make some deferred contribution. Unlike under traditional 401(k) plans, employers, however, must either make matching contributions up to 3% of each employee's pay, or a non-elective contribution of 2% of each eligible employee's pay.<sup>553</sup>

### 7.3.2 IRA

Individual retirement arrangements (IRAs) are personal savings plans provided by financial institutions that qualify for tax advantages for setting aside money for retirement in the US.<sup>554</sup>

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<sup>545</sup> See for the notice requirement: 26 CFR 1.401(k)-3(d)(2); See for the timing requirement: 26 CFR 1.401(k)-3(d)(3).

<sup>546</sup> U.S. Department of Labor, *Choosing a Retirement Solution for Your Small Business*, <https://www.irs.gov/pub/irs-pdf/p3998.pdf> (accessed 14 January 2017).

<sup>547</sup> 26 CFR § 1.401(k)-4 SIMPLE 401(k) plan requirements; See also Internal Revenue Service, *Choosing a Retirement Plan: SIMPLE 401(k) Plan*, <https://www.irs.gov/retirement-plans/choosing-a-retirement-plan-simple-401k-plan> (accessed 14 January 2017).

<sup>548</sup> Internal Revenue Service, *Publication 560 Retirement Plans for Small Business (SEP, SIMPLE and Qualified Plans)*, <https://www.irs.gov/pub/irs-pdf/p560.pdf> (accessed 14 January 2017).

<sup>549</sup> U.S. Department of Labor's Employee Benefits Security Administration (DOL/EBSA) & the Internal Revenue Service, *401(k) for Small Businesses*, <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/401kPlansSmallBusiness.pdf> (accessed 14 January 2017).

<sup>550</sup> 26 CFR § 1.401(k)-4 (a).

<sup>551</sup> 26 CFR § 1.401(k)-4 (b).

<sup>552</sup> U.S. Department of Labor, *Choosing a Retirement Solution for Your Small Business*, <https://www.irs.gov/pub/irs-pdf/p3998.pdf> (accessed 14 January 2017).

<sup>553</sup> 26 CFR § 1.401(k)-4 (e)(3) and (4).

<sup>554</sup> Internal Revenue Service, *Contributions to Individual Retirement Arrangements (IRAs)*, Publication 590-A (2016), 3, <https://www.irs.gov/pub/irs-pdf/p590a.pdf> (accessed 14 January 2017); *US Government Accountability Office (GAO), IRS Could Bolster Enforcement on Multimillion Dollar Accounts, but More Direction from Congress Is Needed*, GAO-15-16, October 2014, <http://www.gao.gov/products/GAO-15-16> (accessed 14 January 2017); Internal Revenue Service, *Pension and Annuity Income*, Publication 575 (2016), <https://www.irs.gov/pub/irs-pdf/p575.pdf> (accessed 14 January 2017).

The term IRA is, however, used for a large variety of individual retirement accounts and arrangements that have as a common denominator that a trust or custodial account is set up for the benefit of the beneficiary/taxpayer.<sup>555</sup> Depending upon the type of IRA and personal circumstances, contributions are fully or partially tax deductible and not taxed until distributed.<sup>556</sup> The most common types of IRAs are traditional IRAs<sup>557</sup>, Roth IRAs<sup>558</sup>, SEP IRAs<sup>559</sup> and SIMPLE IRAs<sup>560</sup>.

### 7.3.2.1 Traditional IRA

Traditional IRAs, also referred to as ‘ordinary’ or ‘regular IRAs’, were introduced with the Employee Retirement Income Security Act of 1974 (ERISA) and became popular with the Economic Recovery Tax Act of 1981. They are IRAs that are not Roth or SIMPLE IRAs and characterized by contributions that are tax-deductible, i.e. ‘contributions are made with pre-tax assets’.<sup>561</sup> The transactions and earnings taking place within the IRA are tax irrelevant provided that the IRA contains only assets that makes the IRA a ‘deductible IRA’ and certain contribution and deduction limits are being taken into account.<sup>562</sup> ‘Non-deductible IRAs’ and contributions falling outside the scope of the Report and deduction regime fall outside the traditional IRA tax favourable regime.<sup>563</sup> Distributions, subject to certain limits, are taxed as income.<sup>564</sup> Some financial institutions in the US allow for so-called ‘self-directed IRAs’ that allow for alternative investments, i.e. investments in real estate, private mortgages, private company stock, oil and gas limited partnerships, in IRAs.<sup>565</sup> The Internal Revenue Service regulations require that a qualified trustee, or custodian, hold these IRA assets on behalf of the IRA owner that are allowed to restrict the types of assets they will handle in addition to Internal Revenue Code restrictions.<sup>566</sup>

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<sup>555</sup> R. Eisenberg, *IRAs Congress' big gift to working Americans*, *The Daily Oklahoman*, 16 December 1981;

<sup>556</sup> Internal Revenue Service, *Contributions to Individual Retirement Arrangements (IRAs)*, Publication 590-A (2016), 3, <https://www.irs.gov/pub/irs-pdf/p590a.pdf> (accessed 14 January 2017).

<sup>557</sup> See for Traditional IRAs : <https://www.irs.gov/retirement-plans/individual-retirement-arrangements-iras-1> (accessed 14 January 2017).

<sup>558</sup> J. E. Buckley, *Comparison of Roth 401k, Roth IRA, and Traditional 401k Retirement Plans*, [http://www.401khelpcenter.com/dol/pr\\_dol\\_rothcomparisonchart.html#.WGpZbEaC7Qg](http://www.401khelpcenter.com/dol/pr_dol_rothcomparisonchart.html#.WGpZbEaC7Qg) (accessed 14 January 2017).

<sup>559</sup> Internal Revenue Service, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*, Publication 560 (2016), <https://www.irs.gov/pub/irs-pdf/p560.pdf> (accessed 14 January 2017).

<sup>560</sup> Internal Revenue Service, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*, Publication 560 (2016), <https://www.irs.gov/pub/irs-pdf/p560.pdf> (accessed 14 January 2017).

<sup>561</sup> Internal Revenue Service, *Contributions to Individual Retirement Arrangements (IRAs)*, Publication 590-A (2016), 5, <https://www.irs.gov/pub/irs-pdf/p590a.pdf> (accessed 14 January 2017).

<sup>562</sup> Internal Revenue Service, *Contributions to Individual Retirement Arrangements (IRAs)*, Publication 590-A (2016), <https://www.irs.gov/pub/irs-pdf/p590a.pdf> (accessed 14 January 2017).

<sup>563</sup> <https://www.irs.gov/retirement-plans/individual-retirement-arrangements-iras-1> (accessed 14 January 2017).

<sup>564</sup> <https://www.irs.gov/retirement-plans/individual-retirement-arrangements-iras-1> (accessed 14 January 2017).

<sup>565</sup> 26 U.S. Code § 408 - Individual retirement accounts.

<sup>566</sup> Securities and Exchange Commission, *Investor Alert: Self-Directed IRAs and the Risk of Fraud*, <http://www.sec.gov/investor/alerts/sdira.pdf> (accessed 14 January 2017).

### 7.3.2.2 Roth IRA

Roth IRAs were introduced as part of the Taxpayer Relief Act of 1997. A Roth IRA is an individual retirement plan that are largely subject to the same rules that apply to traditional IRAs. In contrast to a traditional IRA, contributions to a Roth IRA are, however not tax-deductible.<sup>567</sup> Roth IRAs, thus, consist of contributions made with after-tax assets.<sup>568</sup> All financial transactions, including capital gains, dividends, and interest, within the IRA do not have any tax consequences and withdrawals are free provided that certain conditions are being complied with.<sup>569</sup> The difference in tax treatment between traditional and Roth IRAs also has resulted in several differences related to the contribution and deduction tax regime and the eligible assets in which the Roth IRA is allowed to be invested. For example, the contributions made to Roth IRAs may be withdrawn tax-and penalty-free at any time, whereas Roth IRA earnings may be withdrawn tax-and penalty-free after 5 years if the condition of age 59½ and other qualifying conditions are also met.<sup>570</sup> Contributions may be made to a Roth IRA even if the owner participates in a qualified retirement plan such as a 401(k).<sup>571</sup> Roth IRAs, thus, have fewer withdrawal restrictions than traditional IRAs.

### 7.3.2.3 SEP IRA

A Simplified Employee Pension Individual Retirement Arrangement (SEP IRA) is a variation of the IRA in which employers of small businesses or self-employed individuals may make contributions in traditional IRAs that are established for themselves and their employees.<sup>572</sup> Since SEP IRAs are a type of IRA, contributions can be invested the same way as traditional IRAs. Employers may place conditions on employee eligibility. Employees, however, must be included in the SEP IRA plan when they are 21, have worked for the employer in three of the

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<sup>567</sup> Internal Revenue Service, *Retirement Plans FAQs on Designated Roth Accounts*, <https://www.irs.gov/retirement-plans/retirement-plans-faqs-on-designated-roth-accounts> (accessed 14 January 2017); Internal Revenue Service, *Designated Roth Accounts Under a 401(k) or 403(b)*, Plan Publication 4530 (Rev. 4-2012) - IRS.gov, <https://www.irs.gov/pub/irs-pdf/p4530.pdf> (accessed 14 January 2017).

<sup>568</sup> Internal Revenue Service, *Designated Roth Accounts - Contributing to a Designated Roth Account*, <https://www.irs.gov/retirement-plans/designated-roth-accounts-contributing-to-a-designated-roth-account> (accessed 14 January 2017).

<sup>569</sup> Internal Revenue Service, *Amount of Roth IRA Contributions That You Can Make for 2016*, <https://www.irs.gov/retirement-plans/plan-participant-employee/amount-of-roth-ira-contributions-that-you-can-make-for-2016> (accessed 14 January 2017).

<sup>570</sup> Internal Revenue Service, *Contributions to Individual Retirement Arrangements (IRAs)*, Publication 590-A (2016), 40, <https://www.irs.gov/pub/irs-pdf/p590a.pdf> (accessed 14 January 2017).

<sup>571</sup> Internal Revenue Service, *Roth Comparison Chart*, <https://www.irs.gov/retirement-plans/roth-comparison-chart> (accessed 14 January 2017); J. E. Buckley, *Comparison of Roth 401k, Roth IRA, and Traditional 401k Retirement Plans*, [http://www.401khelpcenter.com/dol/pr\\_dol\\_rothcomparisonchart.html#.WGpZbEaC7Qg](http://www.401khelpcenter.com/dol/pr_dol_rothcomparisonchart.html#.WGpZbEaC7Qg) (accessed 14 January 2017).

<sup>572</sup> Internal Revenue Service, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*, Publication 560 (2016), <https://www.irs.gov/pub/irs-pdf/p560.pdf> (accessed 14 January 2017).

previous five years and received at least \$600 in compensation from the employer during the year (for 2015, 2016 and 2017).<sup>573</sup> SEP IRAs are similarly taxed as traditional IRAs.<sup>574</sup>

#### 7.3.2.4 SIMPLE IRA

A Savings Incentive Match Plan for Employees Individual Retirement Account (SIMPLE IRA) is a type of tax-deferred employer-provided retirement plan in the US. It is a type of IRA that is being sponsored by employers such as 401(k) and 403(b)575 plans.<sup>576</sup> SIMPLE IRAs are similar to 401(k) plans, but have lower contribution limits, as compared to conventional defined contribution plans<sup>577</sup>, and simpler administration. Like a 401(k) plan, SIMPLE IRAs may be funded by pre-tax salary reduction. Nevertheless, contributions are still subject to Social Security, Medicare, and Federal Unemployment Tax Act taxes. Apart from Roth IRAs, the tax treatment of the SIMPLE IRA is similar compared to the above types of IRAs, particularly for rules regarding distributions.<sup>578</sup> SIMPLE IRAs also have additional rules how contributions can and must be made and what employees are qualified to participate.<sup>579</sup>

#### 7.3.3 Conclusion

The US has already gathered experience with 401(k) and IRA plans over the past three decades. Similar as for PEPPs on the European level, both the employer-sponsored 401(k) and third-pillar IRA plans were introduced to overcome problems related to pension funds and the resulting 'pension gap' that were faced in the US. In contrast to PEPPs, an overview of the regulatory framework of 401(k) and IRA plans showed that both the 401(k) and IRA plans are based upon tax legislation. In addition, the employer-sponsored 401(k) plans and IRAs are largely comparable and based upon the same principles. The overview of the regulatory framework of 401(k) and IRA plans indicates that the PEPP might inspire the European regulator and individual Member States to extend the PEPP to the second-pillar domain.

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<sup>573</sup> Internal Revenue Service, *Who Can Participate in a SEP or SARSEP Plan?*, <https://www.irs.gov/retirement-plans/plan-participant-employee/who-can-participate-in-a-sep-or-sarsep-plan> (accessed 14 January 2017); Internal Revenue Service, *SEP Plan FAQs - Participation Requirements*, <https://www.irs.gov/retirement-plans/sep-plan-faqs-participation-requirements> (accessed 14 January 2017).

<sup>574</sup> Internal Revenue Service, *Simplified Employee Pension Plan (SEP)*, <https://www.irs.gov/retirement-plans/plan-sponsor/simplified-employee-pension-plan-sep> (accessed 14 January 2017).

<sup>575</sup> These are Tax Sheltered Annuity plans. See Internal Revenue Service, *Designated Roth Accounts Under a 401(k) or 403(b)*, Plan Publication 4530 (Rev. 4-2012) - IRS.gov, <https://www.irs.gov/pub/irs-pdf/p4530.pdf> (accessed 14 January 2017).

<sup>576</sup> Internal Revenue Service, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*, Publication 560 (2016), <https://www.irs.gov/pub/irs-pdf/p560.pdf> (accessed 14 January 2017).

<sup>577</sup> Examples are Section 402(g), 401(k), 401(a), and 403(b) plans.

<sup>578</sup> Internal Revenue Service, *SIMPLE IRA Plan*, <https://www.irs.gov/retirement-plans/plan-sponsor/simple-ira-plan> (accessed 14 January 2017).

<sup>579</sup> Internal Revenue Service, *Operating a SIMPLE IRA Plan*, <https://www.irs.gov/retirement-plans/operating-a-simple-ira-plan> (accessed 14 January 2017).



## **7.4 The Netherlands – The Premium Pension Institution (PPI)**

The Dutch PPI is an IORP which – albeit a second pillar institution - can be a source of inspiration for the PEPP. It contains individual ownership, VAT exemption in line with CJEU case law, a straightforward governing board, a relatively simple tax regime and is modelled to unbundle all services required to operate a pension scheme.<sup>580</sup> The PPI can deliver a broad range of pension services. Although it was originally not permitted to cover any insurance risks (eg, biometric risks), this was amended by Dutch Law in September 2016. Before that date, financial obligations of a PPI consisted of the payment to participants of the accumulated pension capital. If a pension scheme obligatorily must provide for a benefit for life, the obligation of a PPI consisted of a transfer of the accrued pension capital to an insurance company or another institution as the PPI was not allowed to cover insurance risks.

In the case of a Dutch pension scheme, a PPI could only operate the accumulation phase. The payout phase of the pension benefits will be exercised by another IORP either within the Netherlands or in another Member State. A major advantage of the aforementioned limitation of the scope of a PPI is that many requirements of the (Dutch) supervisory legislation do not need to be met. For instance, a PPI does not need to fulfil a number of prudential rules (supervised by the Dutch Central Bank) that are applicable to a common Dutch pension fund, such as the obligation to maintain technical provisions and to meet solvency requirements. Also, no potential recovery plans apply. A PPI could, however, in its original form also operate foreign DB schemes, as long as the biometrics risks of the scheme do not rest upon the PPI. This meant that, for example, a PPI can fully operate a Belgian lump sum pension scheme. The Dutch PPI can, thus, be a source of inspiration for the PEPP.

## **7.5 Conclusion**

A review of current PPP regimes in Sweden, the UK and the US have indicated that the regulatory and tax regime of PPP regimes, on the one hand, and second- and third-pillar PPP regimes are more closely aligned than so far has been assumed. In Sweden, for example, the successful third-pillar IPS regime had been introduced in the 90's but its tax advantages were recently abolished. The abolishment was made upon the assumption that most Swedes are covered by the overhauled Swedish second-pillar personal pension accounts regime that are deemed to be providing sufficient retirement income. For this reason, Sweden only maintains tax advantages for Swedes investing in IPS third-pillar accounts that are not covered by its second-pillar regime.

In the UK and the US, the close alignment is more evident. The UK has different types of personal pensions including (Group) stakeholder pension schemes, (Group) SIPP and (Group) Personal Pension. For regulatory and tax purposes, the differences between the personal and

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<sup>580</sup> Parts of this paragraph were taken from: H. van Meerten & W. Mulder, *The Netherlands: A New Dutch IORP*, <https://www.ipe.com/the-netherlands-a-new-dutch-iorp/36681.fullarticle> (accessed 14 January 2017).

occupational pensions in the UK are not clear-cut. Personal pension schemes may be invested in by employed, unemployed or self-employed people. In this regard, personal pensions that are ‘Group’ pensions are being provided by employers for their employees. Nevertheless, employers may agree with their employees to contribute to their stakeholder pension schemes or SIPPs. This nature is also reflected by the tax relief applying to contributions to all types of personal pension schemes. Similarly, the employer-sponsored 401(k) and (third-pillar) IRA plans in the US are largely comparable and similarly regulated for tax purposes. An overview of the regulatory framework of PPPs in Sweden, the UK and the US, thus, indicates that the PEPP might inspire the European regulator and individual Member States to extend the PEPP to the second-pillar domain and that more Member States might introduce a ‘compensating layer’, taking into account pension savings made in both the second- and third-pillar. Although being a second-pillar product, the Dutch PPI could also serve as an inspiration for the PEPP.

## 8 Conclusion

In the last couple of years questions arose how the PEPP should ideally be regulated and the European Commission and various interest groups, have to date not found a solution for all possible problems in developing a common regulatory framework. The only viable way how to establish a harmonized PEPP regime is by defining and regulating PEPPs as wrappers of existing (EEA) third-pillar pension products. The product would be required to comply with ‘common features’ of voluntary personal pension plans and fulfill additional mandatory elements, such as a default investment option, limited investment choices and flexible elements that include guarantees and the switching between providers. Only allowing EEA regulated third-pillar pension products would ensure that PEPP providers cannot enter into regulatory arbitrage by choosing a less well regulated underlying national product as part of a PEPP.

EIOPA indicated in several policy documents that it believes that the internal market for PEPPs would be substantially enhanced if a PEPP product passport would be introduced.<sup>581</sup>

To facilitate the ‘mutual recognition’ approach and overcome ‘risk asymmetry’, the European passport was proposed in this Report to be based upon a common European substantive legislative and supervisory framework. In line with recent legal initiatives, including the ELTIFR, EuSEFR, EuVECAR and the proposed MMFR, it would be logical that the PEPP initiative will also be established as a regulation. Together with the European System of Financial Supervision introduced in 2011, this would ensure that the PEPP initiative would also be adequately enforced by home/host Member States and the supranational ESAs.

The full governance under such a PEPP regulation would involve intermediaries (PEPP provider and distributor), the depositary, the position of consumers, the PEPP product and sales/disclosure regulation.<sup>582</sup>

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<sup>581</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006.



For that purpose, current sectoral authorization regimes should be used and the provision of PEPP should be limited to those providers authorized under relevant European legislation.<sup>583</sup> This allows EEA regulated intermediaries that already offer third-pillar retirement products to be eligible as a PEPP provider. For the provision of a PEPP, PEPP providers may, however, only offer those PEPPs that contain an underlying third-pillar retirement product for which they are authorized under EEA sectoral legislation.<sup>584</sup> Consequently, the authorization of a PEPP provider limits the range of PEPPs that may be offered to consumers in the accumulation phase, as well as, the payout solution in the decumulation phase.

Distributors can be part of the PEPP provider, an agent of a PEPP provider or a third party.<sup>585</sup> The sectoral approach allows AIFMs and UCITS ManCos as PEPP providers to market AIF/UCITS units to consumers. In addition, investment firms/credit institutions under MiFID II and insurance companies/undertakings under the IDD would be allowed to distribute PEPPs. Under this approach, both product manufacturers that manufacture and distribute PEPPs and distributors that merely distribute products that are manufactured by other providers would be targeted.<sup>586</sup>

Including a sector-specific requirement based on the underlying third-pillar pension product on the use of depositaries reflects, indeed, the business model of PEPPs the best.

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<sup>582</sup> See for the regulation financial intermediaries, in particular depositaries: Hooghiemstra, S.N., *Depositaries in European Investment Law: Towards Harmonization in Europe*, Phd 2017 (forthcoming); A. Byrne, A., D. Harrison & D. Blake, *Defined Contribution Pensions: Dealing with the Reluctant Investor: Innovation and Governance in DC Pension Investment*, [http://www.pensions-institute.org/reports/PI\\_DC\\_Investment\\_Final.pdf](http://www.pensions-institute.org/reports/PI_DC_Investment_Final.pdf) (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 9-10; Cf. Organisation for Economic Co-operation and Development, *Guidelines on Pension Fund Governance*, <http://www.oecd.org/dataoecd/18/52/34799965.pdf> (access 21 December 2016); International Organisation of Pension Supervisors, *Supervising default investment funds*. IOPS Working Papers on Effective Pensions Supervision, No.18 (2012).

<sup>583</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>584</sup> European Insurance and Occupational Pensions Authority, *Final Report on Public Consultation No. CP-15/006 on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 11 April 2016, EIOPA-16-341, 11.

<sup>585</sup> International Organisation of Securities Commissions, *Investment Management Risk Assessment: Marketing and Selling Practices*, <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD156.pdf> (accessed 14 January 2017); European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 40.

<sup>586</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 1 February 2016, EIOPA-CP-16/001, 48; European Insurance and Occupational Pensions Authority, *EIOPA's advice on the development of an EU Single Market for personal pension products (PPP)*, 04 July 2016, EIOPA-16/457, 48.

In overcoming the information asymmetry gap between the financial services industry and consumers, disclosure should be provided that takes into account the specific needs of consumers during the life cycle of a PEPP.<sup>587</sup> The information provided in the pre-contractual phase could be modelled after the PRIIPR that currently already cover IBIPs and other retirement products that may underlie a PEPP. In the ongoing or accumulation phase, the Pensions Benefit Statement (PBS) introduced under IORPD II could provide additional appropriate annual information that could be given to PEPP consumers.<sup>588</sup> Finally, the ‘other information and documents’ that are to be provided under Chapter 3 IORPD could adequately inform consumers about the start of the decumulation phase and what decumulation options can be chosen in both phases.<sup>589</sup>

Upon concluding the PEPP contract, consumers are limited by picking amongst a limited number of investment options that are manufactured by the PEPP provider and are regulated by intermediary (PEPP provider, distributor), product and sales regulation. The retirement objective prevents consumers from exiting all PEPP investments. The objective of saving until retirement requires consumers to remain invested in a PEPP either offered by their own or another provider. Consumers, thus, have strong exit rights that are limited by switching providers and transfer of funds.

The European Commission and various interest groups have expressed their concern that tax obstacles could prevent the creation of an effective single market for PEPPs.<sup>590</sup> Over the past decades, the CJEU has mostly eradicated tax discrimination in its case law.<sup>591</sup> Nevertheless, problems related to system diversity and the ‘pensionista problem’ remain. In these areas, differences between the taxation systems of Member States related to the deductibility of contributions and the taxation of benefits could possibly pose a problem for PEPP holders.<sup>592</sup>

Broad acceptance of the EET system and extending existing systems to PEPPs would encourage pension savings. Tax deferral has proven to be an effective incentive for taxpayers to save for retirement. To encourage PEPP investments, Member States could consider applying

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<sup>587</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 25-33.

<sup>588</sup> Art. 40 and 40a IORPD II.

<sup>589</sup> European Insurance and Occupational Pensions Authority, *Consultation Paper on the creation of a standardised Pan-European Personal Pension product (PEPP)*, 3 July 2015, EIOPA-CP-15/006, 32.

<sup>590</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 37.

<sup>591</sup> P. Schonewille, *To what extent is tax still an issue for IORPS?*,

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ipe\\_sep2005.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ipe_sep2005.pdf) (accessed 13 January 2017);

P. Schonewille, *The elimination of tax obstacles to pan-European pension funds: An overview*,

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/occ\\_pen\\_article3.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/occ_pen_article3.pdf) (accessed 13 January 2017).

<sup>592</sup> Commission of the European Communities, *Communication from the Commission to the Council of 19 April 2001, the European Parliament and the Economic and Social Committee: The elimination of tax obstacles to the cross-border provision of occupational pensions*, COM(2001) 214 final, 18.

the principle of ‘compensating layers’, or substitute tax relief, by a matching contributions system. Extending the EET system to all Member States would eradicate most, but not all, problems. EET systems are complicated and may lead to double (non)taxation in migration cases. Politically, it is hardly feasible to harmonize the direct taxation field. For this reason, the sole realistic remedy seems to be a renegotiating of tax treaties between the Member States concerned. Even if tax obstacles are not remedied on the European level, the introduction of the PEPP would still lead to a single market for PEPPs, as it facilitates the cross-border supply of PEPPs and enhances consumer choice and reduces costs.<sup>593</sup>

An overview of the regulatory framework of PPPs in Sweden, the UK and the US, thus, indicates that the PEPP might inspire the European regulator and individual Member States to extend the PEPP to the second-pillar domain and that more Member States might introduce a ‘compensating layer’, taking into account pension savings made in both the second- and third-pillar.

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<sup>593</sup> European Fund and Asset Management Association, *The OCERP: a Proposal for a European Personal Pension Product*, September 2013, 38.

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