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# Pan-European Pension Product

## *Dutch Pension Perspectives*

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## Summary

- A pan-European pension product (PEPP) is a voluntary pension scheme that will offer consumers a new option to save for retirement.
- PEPP can be offered by a broad range of financial companies such as insurance companies, banks, occupational pension funds, certain investment firms and asset managers.
- We expect the PEPP to be more successful in some countries than others.
- In addition, we expect the introduction of the PEPP to have a limited impact on the Dutch pension market.
- The success of PEPP in most countries will depend on the national tax treatment.
- We see challenges for the proposed standardisation in PEPP due the differences in the national tax and legal frameworks.

## What is a Pan-European Pension Product?

The European Commission has published a proposal for a Pan-European Pension Product on 29 June 2017.

PEPP is a voluntary personal pension scheme that offers consumers a new pan-European option to save for retirement. The initiative is complementary to the existing products and plans and will not replace them. The Commission's proposal will lay down the foundations for a pan-European personal pension market, ensuring standardisation of the core product features, such as transparency requirements, investment rules, switching and portability.

Core features of the PEPP are:

- Possibility for transferring accrued capital between providers within and across borders;
- Investment in derivative instruments is only allowed if the instrument contributes to a reduction of investment risk or facilitates efficient portfolio management;
- PEPP provides one or more withdrawal options: annuity, lump sum, drawdown payments or a combination;
- Conditions related to the withdrawal phase like the retirement age shall be determined by the member states;
- Supervision is done by the competent national authority and additional monitoring by European Insurance and Occupational Pension Authority (EIOPA).

PEPP can be offered by a broad range of financial companies such as insurance companies, banks, occupational pension funds, certain investment firms and asset managers. An important assumption and recommendation of the Commission is that national governments will offer the same tax exemption for the PEPP as for other pension products in their country.<sup>1</sup>

<sup>1</sup> [European Commission – Pan-European Pension Product – Frequently asked questions](#)

## Why was PEPP introduced?

The Commission mentions several arguments for the introduction of this product:

1. The ageing population with falling birth rates and increasing life expectancy leads to challenges in the public funding of pay-as-you-go pensions. Pay-as-you-go (PAYG) is a method of financing where the retirement benefit payment is paid through taxes by the current workers. These challenges will possibly lead to a decrease in income after retirement which can result in an increase in demand for fiscally friendly savings. The PEPP is intended to offer this possibility in a standardised way.
2. The European market for personal pensions is fragmented. The availability of pension products is concentrated in a few countries while in some others these products are almost non-existent. This fragmentation can be explained by the different institutional and legal frameworks at the national levels. The PEPP will provide building blocks for pension products on a pan-European scale.
3. A more developed market for pensions in the EU will increase long term investment and increase the efficiency, depth and liquidity of the capital markets. This will contribute to the objectives of EU's plan for a Capital Markets Union.
4. The PEPP will introduce a simple, transparent and cost-effective option to save for retirement for the consumer.<sup>2</sup>

In addition we think that the introduction of the PEPP facilitates an increase in European labour mobility.

## Success or failure?

Whether PEPP will actually be a success will depend on several factors. We have sorted these in supply and demand factors which will be discussed separately and will most likely differ per country.

### Supply

The European market for (personal) pensions is fragmented. The availability of products is concentrated in a few countries like France, Spain, Germany and Denmark while in some others like Slovakia, Hungary and Slovenia these products are almost non-existent.<sup>3</sup>

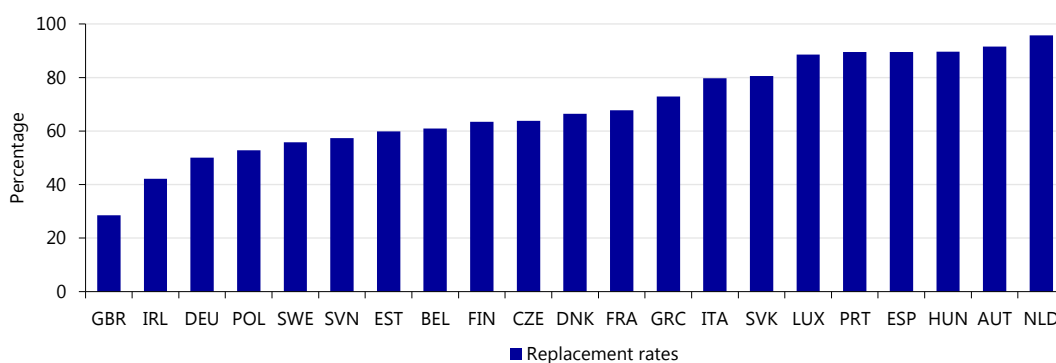
Also there is great disparity between the amount of savings between the member states as shown in the replacement rates (net pension income as a % of net pre-retirement income) in figure 1. The Netherlands in 2014 had a net replacement rate of 96% while Ireland only had 42%. Low replacement rates indicate there can be room for improvement through additional savings in for example a PEPP.

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<sup>2</sup> [European Commission – Pan-European Pension Product – Frequently asked questions](#)

<sup>3</sup> [EY - Study on the feasibility of a European Personal Pension Framework](#)

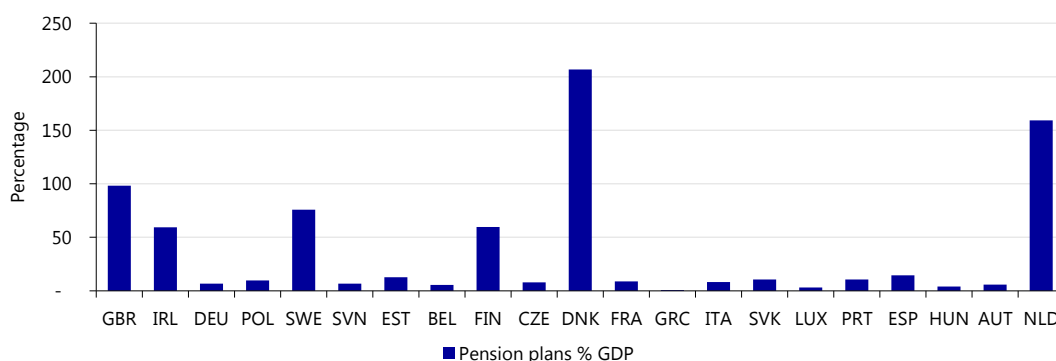
**Figure 1: Net pension replacement rates as % of pre-retirement income in 2014 including PAYG**



Source: OECD

High replacement rates can however indicate large potential pressure on public spending depending on type of financing. Most countries finance the benefits with pay-as-you-go systems while others also depend on fully funded plans. Figure 2 shows the amount of assets saved for retirement as percentage of GDP. Especially countries with small amounts of pension assets as percentage of GDP will face challenges with public funding of their retirement benefits. This will exert a downward pressure on the replacement rates and possibly increase the future demand for PEPP.

**Figure 2: Fully funded pension assets in pension funds or individual plans as % of GDP in 2014**



Source: OECD

Given the differences across member states, some national markets will be more attractive than others. For example Slovenia, with a limited supply of personal pension products, a relative low replacement rate and small amount of pension assets as % of GDP, appears to be a more appealing market than for example the Netherlands with a large supply of pension products, a high replacement rate and large amount of pension assets.

Even though the attractiveness of the different member states varies, any financial institution offering a PEPP is obliged to offer the PEPP in all member states within three years after inception. This will mean costs will have to be incurred in certain markets even if these markets appear not to be commercially attractive.

Another consequence is that costs must be made to comply with national regulatory requirements regarding risk management, compliance and communication in all member states. Currently most of the national regulatory requirements differ a lot between member states. When implemented, PEPP will at least have to comply (with some of) these local rules which contradicts the goal of offering a simple, transparent and cost effective option. We think the differences in legislation regarding saving for retirement will result in challenges to maintain standardisation and cost effectiveness. According to a report by Ernst & Young, the biggest differences in fiscal treatment have to do with the possibility of transferring the accrued amount between providers

and the possibility of early pay-out.<sup>4</sup> Offering a net pension product (TEE<sup>5</sup>) would be more straightforward, but is less customary in most European countries.

### **Demand**

Due to demographic challenges, state benefits are expected to decrease which will mean people will have to voluntarily save for their retirement. But will people who wish to save for their retirement use a PEPP?

- Disposable Income – The people with low incomes are often hit the hardest by the reduction in state benefits. We question whether this group will have the income or the access to invest in a PEPP. Middle and high (mobile) income households in countries with limited supply of personal pension products will be able to benefit from PEPP.
- Tax exemption - Will all member states adopt the tax exempt policies or will the product be a net pension product? If there is no tax exemption we expect there will be limited interest in the PEPP.
- Confidence - The confidence in the financial sector differs per country and also the overall confidence in the sector has taken a hit during the financial crisis. Furthermore, if no domestic PEPP provider is available, will a consumer have the confidence to invest with a PEPP supplier from another country? A consumer from for example Italy might be interested to invest in a PEPP of a German bank but we question whether a consumer from Germany will invest in a PEPP of an Italian bank.

## How does this affect the Dutch pension market?

We expect the introduction of the PEPP to have a limited impact on the voluntary pension savings in the Dutch pension market. This is due to:

- The significant amount of state and mandatory occupational pensions most already accrue as shown in the replacement rates in figure 1. Also, a large part of these benefits are funded with assets as shown in figure 2 which means lower dependency on public spending.
- The large availability of individual personal pension products. This was also stated in the initial reactions of the Dutch Association of Insurers (Verbond van Verzekeraars) and the Federation of the Dutch Pension Funds (Pensioenfederatie) to the introduction of the PEPP.<sup>6</sup>
- Decreasing demand for individual life insurance products as shown in figure 3 with annual sales well over a €1bn in 2006 to less than €200m in 2015. The decrease in sales can be explained by a loss of confidence in investment linked products that still persists due to large and non-transparent fees that were charged on these products ('Woekerpolissen') from the 90's up until mid 00's.

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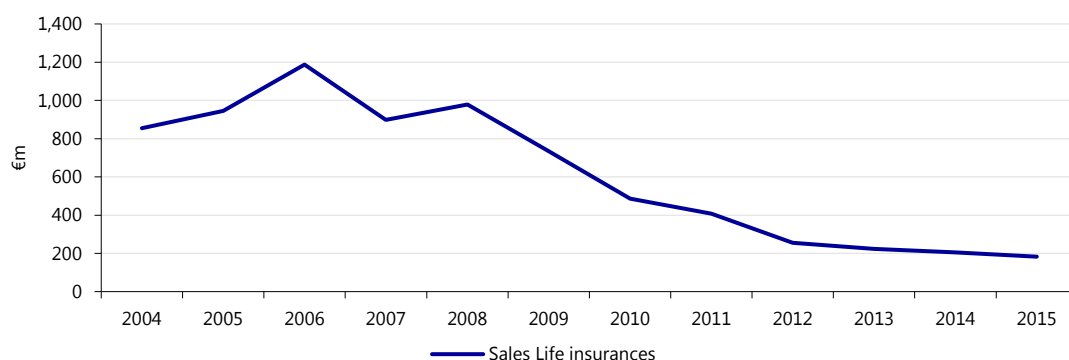
<sup>4</sup> [EY – Study on the feasibility of a European Personal Pension Framework](#)

<sup>5</sup> TEE stands for Tax, Exempt, Exempt. The premiums are taxed, but accumulation and withdrawal are tax exempt.

<sup>6</sup> See [Verbond van Verzekeraars](#) and [Pensioenfederatie](#)

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**Figure 3: Yearly sales of individual life insurance excluding mortgage linked products**



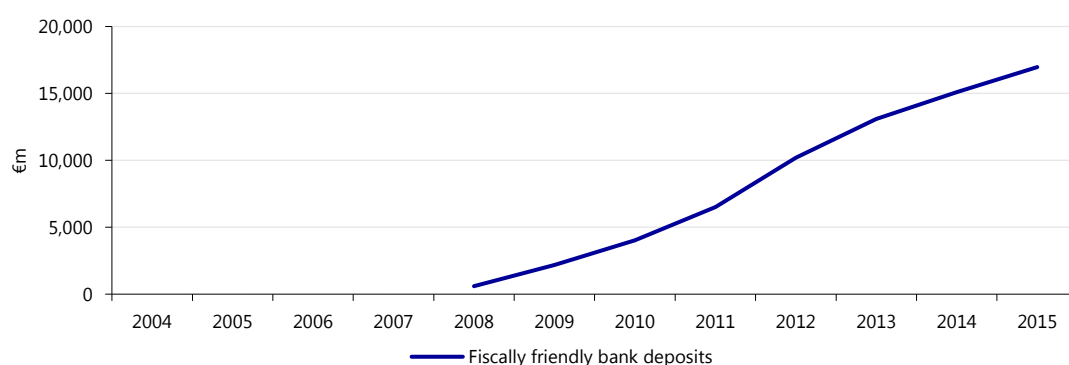
Source: Dutch Association of Insurers

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Another explanation for the drop in sales in individual life insurances has been the introduction of a new private pension product. As of 1 of January 2008 fiscally facilitated bank deposits ("Banksparen") were introduced. This product offers a savings-based interest rate unlike most life insurances where the return depends on the investment return of the portfolio. As shown in figure 4, the amount of fiscally facilitated bank deposits have increased up to €17bn in 2015.

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**Figure 4: Total fiscally friendly bank deposits ("Banksparen") excluding mortgage linked products**



Source: DNB

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As stated above, the majority of Dutch workers already contribute to occupational pension schemes. As a result, they have limited incentive or liquidity to make additional savings – half of all Dutch residents aged 25- 45 has less than €7,000 per household in personal financial assets such as bank deposits or securities<sup>7</sup>.

The introduction of the PEPP can however benefit freelancers and mobile workers who work (temporarily) in the Netherlands. Freelancers do not accrue a pension with an employer so the introduction of the PEPP will offer them another alternative. However, while several individual pension products exist, take-up of such products is low. Only 27% of self-employed workers contribute to a pension plan.<sup>8</sup>

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<sup>7</sup> [Statistics Netherlands, Statline](#)

<sup>8</sup> [Statistics Netherlands, article in Dutch](#)

Mobile workers stand to benefit more because they will be able transfer the accrued benefits between countries, which is currently either not possible, or at least an extensive process.

The decisive factors whether PEPP will be an option to consider for Dutch consumers will depend on:

- If the Dutch government will actually apply the same tax exemption the European Commission recommends for the PEPP as for the other pension products.
- The price and fees of the products when compared to the existing products.

Given the current set-up of the Dutch pension system, we see little added benefit for another individual pension product. However, there is an ongoing debate about the possibility of pension reform in the long run.<sup>9</sup> In the short run, there is a possibility that the maximum pensionable income will be lowered which would enlarge the market for net pension products.<sup>10</sup> Should the Dutch pension landscape change drastically, the interest in a PEPP could increase. Also in the long run, the PEPP can result in an upswing in labour mobility between member states which can then result in an increase in demand for PEPP.

## Conclusion

Overall we think PEPP is a possible solution to the serious demographic challenges the ageing population is facing. The PEPP will be more successful in some countries than others. We expect the introduction of the PEPP to have a limited impact on the Dutch pension market in the short run. In the long run this might change due to changes in pension landscape or changes in labour mobility between member states. The overall success of the PEPP will depend on the tax treatment of the PEPP by member states, the existence of collective and individual pension products and savings and the willingness to invest by the consumer.

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<sup>9</sup> [Ministerie van Sociale Zaken en Werkgelegenheid – Perspectiefnota Toekomst Pensioenstelsel](#)

<sup>10</sup> See [Financieel Dagblad](#) and [Netherlands Bureau for Economic Policy Analysis \(CPB\)](#) (in Dutch)

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