ERFF Consensus Paper
Pan-European Personal Pension Product (PEPP)

The European Retail Financial Forum (ERFF) is a pan-European forum that brings together, through technical workshops and events, consumers, business and policymakers to support the opening up of retail financial markets in Europe. Representing all aspects of the retail sector - traditional, wider investment and digital - we are citizens-focused, favour removing key barriers and increasing choice and transparency for all consumers across borders in ways that keep Europe competitive.[1]

Introduction

There is a strong consensus among ERFF Members (and beyond) that the Pension Gap in Europe must be addressed, and that facilitating 3rd pillar pension initiatives is a good way to do so – there is also a strong consensus that the PEPP initiative is very welcome by all.

However, we believe there is a risk that PEPP might remain a good idea without practical impact unless the project is amended – which might depend on the European Member States more than on the European Commission or the European Parliament.

The PEPP project needs to be bold on tax and portability, humble on default investment and de-cumulation and very open on the distribution model.

1) Tax/financial incentives are essential for the PEPP to work

Opportunity

Financial stimulus plays an important role for consumers to decide to save and invest. In general, tax incentives are used by countries to encourage individuals to save for retirement. Exempting pension contributions from taxation is crucial to incentivise saving and therefore essential for the PEPP to work (and be competitive to already existing third pillar pension products).

Obstacle

Creating a PEPP structure built around national requirements would in effect amount to nothing better than a collection of 28 different national products with a ribbon tied around them – in the

[1] ERFF Consensus Papers reflect the views of our members and associates only: Barclays, Commerzbank, Erste Group, ING, KBC, NN Group, PIMFA (Personal Investment Management and Financial Advice Association); ACCIS, Eurofinas, FECIF.

best case a possibility to transfer between compartments. This is not likely to be attractive – or even feasible - to providers or to bring new benefits to individual investors.

In addition, it is very unlikely that national tax authorities will agree to harmonise their tax treatment of pension products throughout Europe or even to agree to a separate, cross-border tax regime outside national systems.

Solution

Full harmonization of tax treatment within the European Union would be the best solution to make the PEPP a true European pension product and unique in its kind. At this stage, it is however unlikely that it will be part of the current proposal. However unfeasible this may seem at this stage, maybe it could still be part of the proposal in form of a long-term target.

In the current reality, one solution that could be explored would be for PEPP to offer only two compartments, rather than 28, which would dovetail with the majority of existing pension tax regimes:

- One 'EET' compartment where sums invested receive tax relief, build up tax-free and are taxed at exit, in line with many 2nd pillar pension funds in the majority of Member States;
- One 'TEE' compartment where sums are invested after tax, build up tax-free and are tax-free on exit, which is the case for a minority of Member States.

This way, national authorities could more easily align the tax treatment of PEPP with their own national comparable Personal Pension Products, without needing to change local tax rules or to create compartments for every country.

Such a model can only work if all member states offer tax incentives for third pillar pensions products, which isn't the case yet. Therefore, the European Commission should encourage those member states to stimulate pension savings, not only for the PEPP to work but also to help in creating a sustainable pension for all EU citizens in the future.

The PEPP should also avoid setting restrictions on the form of exit (e.g. mandatory annuity purchase or limited access to capital). However well-meaning, such restrictions inevitably reduce the freedom of the participants and might backfire as circumstances change.

2) Provide clear and relevant investment and de-cumulation options

Opportunity

Current plans for the PEPP ask for a limited set of investment options, clearly linked to customers' risk appetite, including a default option. Based on the learnings of behavioural finance, this helps ensure that people will effectively decide to save under PEPP; it is also likely that a very significant proportion of savings will be made on the default option.

The choice for de-cumulation, or exit option at retirement, also needs to be aligned with the specific situation and needs of the investor – and it determines in turn the choice of investment.

Obstacle

There is no clear consensus between parties on the type of default option that should be offered to customers. The discussion focuses on capital guarantees and lifecycle investments, while others argue that consumers should receive absolute protection and optimal growth at the same time, even though these are mutually exclusive.

The purpose of the default option is to provide risk mitigation for the investor. In addition, it is likely to be the option chosen by many consumers who do not have a high level of financial awareness or understanding of investments markets. However, it is not clear if this is best obtained via permanent capital guarantees, which will reduce the purchasing power of savings, or via the possibility for investors to optimise their investment, potentially resulting in a higher fund at retirement.

Solution

PEPP offered to consumers should offer either a capital guarantee or a lifecycle option, if possible both, with the default fund a combination of these options a determined by the product provider.

Similarly, in terms of de-cumulation, all forms of out payments should be allowed (annuities, lump sum, drawdown payments) to be chosen at conclusion of the contract and possibly re-confirmed a few years before retirement date.

Given the differences in financial awareness and expectations as well as the landscape of local products used as a reference, it might make sense for local regulators to have a say on how default options are presented in their market.

3) Empower and involve people to think about their future pension

Opportunity

Saving for retirement is likely to be the most important financial decision that people will have to make over their lifetime. It is complex, alternatives are not easy to compare, the stakes are high and the horizon is very long.

For such a high-stake decision, all should be done to make sure consumers have access to the best information and advice.

Obstacle

The regulatory model of financial advice, as developed in some of the recent European laws, is not making it easy for consumers to be advised or even informed.

The complex and formal processes to ensure consumers receive adequate information before making a decision often results in so much data that people are overwhelmed and unable to decide. At the same time, some regulation is explicitly targeting face-to-face advice as too cumbersome, expensive or even unhelpful.

Solution

If sufficient room is provided in the PEPP framework for personal and client-centric advice, customers will be empowered to make their own decision on the type of product and type of risk they want to take. This can be achieved by giving clients sufficient, high-quality and appropriate information to enable them to compare and choose products. Pre-contractual information requirements must be tailored to the specific nature of the PEPP.

It is arguable that PEPPs should not be sold on a non-advised basis, even if the consumer has chosen the default option. At the very least, the requirement for an appropriateness test should be a pre-requisite in all situations, as a minimum level of saver protection is always necessary. Decisions concerning pension products are numbered amongst the most important that each saver is expected to make in his/her life. Non-advised sales - if in the end these are permitted - should thus be supported, at least, by the appropriateness test, particularly in light of the long-term nature of PEPPs and the need to provide savers with adequate retirement income.
Advice models need to make room for face-to-face advice, automated advice and hybrid models so that consumers can make informed decisions and providers compete on a level playing field.

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Contact: Dr. Fiona Murray, ERFF Secretary General

Email: info@erff.eu

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Members & Associates: Barclays, Commerzbank, Erste Group, ING, KBC, NN Group, PIMFA (Personal Investment Management and Financial Advice Association); ACCIS, Eurofinas, FECIF.