Pensions legislation from Brussels

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Abstract Right from the outset, two of the fundamental objectives of the European Union (as it is called today) have been to facilitate the free movement of labour and the free movement of capital across member states. One of the areas where obstacles to achieving these objectives still remain is that of pensions and social security; another is the wide variation in tax regimes across the EU.

The enormous complexity of the issues is likely to make the eventual resolution of the problems involved very long term indeed. Nevertheless, some progress may be expected over the next few years, because initiatives have recently emerged from two of the Directorates General (DGs) of the European Commission, and these seem to be proceeding with little loss of momentum despite the recent problems on the part of the Commission itself. The first is from DGV — responsible for employment, industrial relations and social affairs. The other is from DGXV — responsible for, among other things, completion of the single market in financial services, including insurance and pension funds.

This paper looks at both initiatives, their scope and the present state of play on each.

Keywords: *Europe; pensions; mobile workers*

Directive on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community — DGV

This Directive is dated 29th June, 1998. EU Directives are binding instructions to member states on goals to be achieved, but the way in which this is to be done is left to the discretion of each state.

This Directive gives member states three years to comply with its provisions.

Given its objectives, it is a disappointment that the Directive is silent on the important question of the

harmonisation of qualifying (or vesting) periods, which are as long as ten years in Germany. However, the preamble to the original proposal for the Directive speaks of the need for 'deepening the analysis' of this and other remaining obstacles to free movement.

Despite this omission, the Directive does introduce significant measures in the following areas.

Preservation rights (Article 4)

This Article deals with the principle of the preservation of vested rights (but

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not with actual vesting periods) of members who cease to contribute to a scheme when moving from one member state to another. The aim is the full preservation of vested rights and the Directive requires member states to take the necessary measures to ensure that they are guaranteed 'to the same extent as for members in respect of whom contributions are no longer being made but who remain within the same member state.

Cross-border payment of pensions (Article 5)

This Article simply requires all member states to ensure that scheme benefits are paid to members or their dependants wherever they may be in the EU. The Article states that such payments should be 'net of any taxes and transaction charges which may be applicable ...'.

Short-term secondments (Article 6)

The aim of Article 6 is to allow posted workers and their employers to continue to make contributions to a pension scheme in their country of origin during the posting. This is intended to be in line with existing rights in relation to statutory social security schemes under Regulation (EEC) No. 1408/71. (This Regulation essentially covers postings of up to two years, although member states can, and frequently do, agree longer periods between themselves.)

Article 6 also specifies that, when contributions continue to be made to a scheme in one member state (eg, in the worker's country of origin), another member state (such as the one in which the posting is based), will not be able to compel membership of a compulsory scheme in that country.

Information for scheme members (Article 7)

Article 7 requires member states to ensure that members are given all the information they need about their pension rights and the choices available to them when they move from one member state to another. Conceivably, this could lead to further disclosure regulations in the UK in order to comply.

Green Paper: Supplementary pensions in the single market (DGXV)

In EU terms, a Green Paper is a consultative document intended to stimulate debate and launch a consultative process. This particular document explores the variety of pension arrangements around the European Union, and raises a wide-ranging series of questions to which the European Commission is seeking answers before deciding how to proceed. Hearings on the issues raised were held in Brussels on 21st April, 1998 and, as a result of the views expressed and debated at the hearings, and of the many written contributions received, policies are expected to emerge before long. In fact, it has already been announced that we may expect a Directive this year aimed at removing the investment restrictions imposed on pension funds by some member states.

The Green Paper points out that 88 per cent of pension payouts in the EU come from pillar 1 (state schemes). When that statistic is put against the fact that 82 per cent of the funded pension assets in the EU are accounted for by just two countries, the UK and the Netherlands, a fairly clear picture emerges of the background against which this discussion document has been produced. It goes on to say that the

need to maintain levels of income in retirement is likely to result in greater reliance being placed on occupational and personal schemes in the future. The considerable problems involved in achieving the development of such supplementary schemes right across Europe, and indeed whether this is necessarily the right way forward, is really the theme of the document.

The main issues raised in the five chapters of the document are summarised below.

Chapter I: The demographic and economic context

This chapter summarises the now well-known demographic changes which are sweeping Europe (as well as the US and Japan), namely, a serious combination of falling birth rates and an ageing population. The result is that, while at the moment there are four people of working age to support each pensioner, by 2040 that figure is expected to have become only two.

Chapter I suggests that the continuing viability of pillar 1 schemes can only be achieved through benefit reductions. This in turn means that the trend towards the development of funded occupational and personal schemes may be expected to continue. However, at this point the Paper goes out of its way to emphasise that funded schemes will not in themselves provide a solution to the current problems of over-reliance on pay-as-you-go schemes around Europe. Funded schemes are not to be seen as a panacea, a point which is re-emphasised elsewhere in the document.

Chapter II: Retirement provision and EU capital markets

This Chapter starts with a summary of

the size of EU pension funds, which is put at 1,198bn ECU, of which the UK accounts for 60 per cent of the total, with the Netherlands in second place at 22 per cent. It suggests that even modest growth rates in the development of funded pensions could easily take asset values to 3,000bn or 5,000bn ECU.

On the subject of investments, it is pointed out that the UK and, to a lesser extent, Ireland stand out because of the high levels of assets invested in equities and the low levels invested in bonds. The UK and the Netherlands also stand out as having as much as 30 per cent and 25 per cent respectively of their assets in 'non-domestic' securities.

There is a discussion about the merits of equity investment which is acknowledged to have produced higher rates of return than bonds historically. However, it stresses that the Commission is not advocating any particular investment strategy for pension funds and makes it clear that this is the role of the fund managers, 'subject only to appropriate prudential supervision' (see Chapter III, below).

A discussion of the risks involved in pursuing higher returns follows, and emphasis is given to what is called the 'prudent man management and supervisory technique used in some member states'. This is the responsibility to invest as a prudent man would invest by matching the liabilities involved with appropriate assets.

Finally, there is a section on the issue of how EU markets could absorb major increases in pension fund and life assurance investments. The broad conclusion is that markets will adapt to take up these funds and that competition between financial institutions and between financial centres in the EU will

lead to improvements in the markets by reducing costs and increasing liquidity.

Chapter III: Appropriate prudential rules for a single market

Chapter III deals with some of the most contentious issues in the Green Paper and starts with the following words:

'It is clear that pension and life insurance funds and the managers of these funds must be subject to prudential supervision. Consumers (ie future pensioners) must be protected in an area where they have little knowledge. Supervision must ensure that fund managers execute their fiduciary duties correctly. The regulatory approaches towards pension funds differ widely between member states. In some states they are covered by regulations specific to pension funds; in others, they are regulated on the same footing as life insurance companies. This means they are subject to the same minimum solvency requirements, rules regarding technical provisions and investment restrictions and other provisions, as life insurance companies.'

While it is fair to say that the requirement for pension funds to be authorised by a competent authority is not in dispute, questions arise about whether the rules for supervising insurance companies should apply to pension funds, and about the effects of excessive rules on the investments of occupational schemes. The freedom for investors, including pension funds, to invest wherever they wish in the EU is a core principle of the original Treaty, but restrictions may be imposed if these can be justified on 'prudential grounds'. This exception is open to abuse and the Commission is in the process of taking action against certain member states that discriminate for non-prudential reasons against foreign assets.

In conclusion, Chapter III suggests a

number of possible ways forward in these areas. The one most likely to be attempted seems to be a Directive setting out the basic principles and allowing the interpretation of the Treaty provisions to be worked out in cooperation with all partners.

Chapter IV: Facilitating the free movement of workers

The Green Paper, which pre-dated the DGV Directive referred to above, extends the discussion into this area, and considers vested rights, transfers from one member state to another and the tax difficulties which arise. It suggests that legislation may be needed to impose a maximum number of years on vesting periods. It also says that, to resolve technical problems relating to the transferability of pension rights, the creation of a 'Community Pensions Forum' could be useful. The point is made that the fact that workers who wish to move within the EU come up against tax obstacles when trying to transfer benefits from one country to another is in conflict with some of the fundamental principles of the original Treaty. As a result, it seems likely that the Commission may begin to make moves into this sensitive area.

Chapter V: The importance of taxation for supplementary pensions

It was announced on 2nd June, 1998 that the proposals in this Chapter are to be dropped and that they have instead been referred to a taxation policy group made up of senior national Ministers. But, for the record, this Chapter deals with the diversity of tax rules across the member states of the EU which, it points out, can be a barrier to job mobility and the cross-border provision of services. The Green Paper also says

that, 'Tax rules that discriminate against a policyholder who buys a policy from an insurer established in another member state run contrary to the freedom to provide services'.

Conclusion

Many of these issues seem like high-level, long-term objectives of the kind for which the European Commission is renowned. However, despite the failure of previous attempts to solve the many problems involved, the

environment for tackling them energetically seems more conducive than it has ever been in the past. It therefore seems likely that progress will be made in some of the areas discussed above before long, and some of the barriers concerned are also being challenged through the courts. Reviews of the practical effects of the proposed changes may therefore be appropriate, especially by employers with schemes covering employees in more than one member state, or with employees seconded elsewhere in the EU.