Original Article

Pensions reform in the European Union: Recent developments after the implementation of the IORP directive

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ABSTRACT The turmoil in the financial markets also has consequences for pension institutions. Evidently, many pension funds have lost a great deal of their assets. Another consequence is less often highlighted: the impact of the crisis on the (cross-border) activity of Institutions for Occupational Retirement Provision (IORPs). This article will mainly deal with recent developments during and after the implementation of the IORP Directive. We will discuss some key aspects of the Directive and the way in which these aspects have been implemented in several EU Member States. We will find that many Member States see opportunities in the Directive, but that the crisis, (legal) uncertainty and incompleteness of the Directive can and/or will be an obstacle to the free movement of pension institutions in the European Union.

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INTRODUCTION

The credit crunch has left its mark on most financial institutions. But before the crunch struck, there was some movement in a territory that only since 2003 came into reach of the EU legislator: the cross-border activity of institutions for occupational retirement provision. After the entering into force in 2005 of a Directive with regard to the activities of and the supervision of these institutions for occupational retirement provision (hereafter, the ‘Directive’),¹ and after

the emerging of several new Institutions for Occupational Retirement Provision (hereafter, IORPs), it seemed that an unexploded time bomb had gone off.² Alas, this proved to be premature. Despite this, it seems opportune to explore some elements of the current state of pension affairs.

As is now commonly known, the EU faces, among others, a demographic deficit. Most EU countries are confronted with an ageing population for which the social provisions are supported by a shrinking number of workers. Demographic change is putting the financing method of governments carrying the ultimate liability for public social security pensions (*pay-as-you-go*) under pressure. Not only in Europe, but all over the world retirement systems are under such pressure. In most

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EU Member States, pensions reform includes the establishment or strengthening of funded private pension provision.³ There is abundant economic evidence that private pensions will have to take up to avert old-age poverty.⁴

As the financing of state-supported social security pensions can no longer be upheld, and the need for occupational retirement provisions is increasing, the EU has addressed the lack of a framework for supplementary pensions, and at the same time the further completion of the Single Market in financial services. In 2003 it published the said Directive. The main activity of an IORP is to operate second and third pillar pension (see below) schemes cross-borderly. The Directive is part of the 'Financial Services Action Plan', but it also touches on social matters, which are only partially harmonised (see para 3.6).

According to the European Commission, IORPs play a major role in retirement and social protection systems in a number of Member States. It is estimated that close on 25 per cent of the Union's active population is covered by an occupational pension scheme. The proportion can be higher than 80 per cent in some countries, such as the Netherlands or Denmark, while relatively low in others. The share of occupational pensions in total pensions is around 10 per cent.⁵ The value of the assets held by these institutions exceeds EUR 2000 billion, that is, it is equivalent to about 25 per cent of the Union's GDP (a little more than 45 per cent for the assets of insurance companies).⁶ They thus play, along with the other financial institutions, a key role in financing Europe's economy and in the operation of the Union's capital markets.⁵

This article will shed some light on recent developments regarding pension reform and the Directive.⁷ We will not deal with highly technical issues, such as how to calculate the solvency margin. Instead, we will focus on some key aspects of the Directive. We will look at the main (EU-law related) problems when and after implementing the Directive (paragraph 2), and will find that difficulties arise when IORPs want to perform services and/or establish themselves in an EU-country other than that in which they are located.

An interesting question is furthermore that of how has this Directive has been implemented in several EU Member States. Recent developments show that more and more multinational companies are looking at the possibilities of setting up a pan-European pension fund. At the time of writing, Ireland, Luxembourg, Belgium and the Netherlands seem the most popular Member States in which to establish an IORP.⁸ IORPs in some Member States section deals with the situation in Belgium, the Netherlands, Ireland and Luxembourg, but those in Germany and France are briefly addressed. Final remarks section concludes and contains some remarks regarding the credit crunch.

THE IORP DIRECTIVE

The Directive was published in the Official Journal on 23 September 2003, with implementation required on 23 September 2005 at the latest.⁹ Formally, all Member States have implemented the Directive.¹⁰ However, infringement proceedings have been enacted against three Member States.¹¹ The Directive also applies to the European Economic Area (EEA). In this section, some key aspects – as defined by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) – with EU-law relevance to the Directive will be discussed: the legal status of an IORP (2.1), the relationship with insurers (2.2),¹² 'ringfencing' (2.3), and, last but not least, the cross-border activity of an IORP (2.4).¹³

For a good understanding of the matter, it is necessary to make four preliminary observations. First, with the IORP Directive a first step towards an internal European pension market has been taken. Central to the Directive is the idea that it becomes possible for pension institutions to operate cross-borderly on an equal playing field. If the institution meets the criteria in the Directive, it qualifies for a European passport. Subsequently, institutions with a European passport must be able to perform services freely and to invest. Various Member States have used the implementation of the IORP Directive to position themselves as an attractive country of establishment for internationally operating

pension institutions (see para 3). The attention of internationally operating companies seems to be focused mainly on the benefits of scale, which can be realised by combining the pension assets (also indicated as asset pooling). This does not mean that no need exists within these companies for an institution that can 'pool' the various pension schemes of employees who are located across Europe. In this way, multinational companies can serve all employees from one place of establishment and provide them with a retirement benefit. The potential advantages of bringing together several pension schemes into one single pension institution apply just as much in the case of pension schemes of different companies that do not necessarily belong to one group.

Second, it is important to note that there are three main categories of pension schemes in the Member States: social security schemes, individual schemes and occupational schemes. Occupational schemes generally involve employer and employees paying into a savings scheme, out of which retirement benefits will be paid to these same employees. Such schemes may be set up within the company itself ('book reserves') or may use the services of a separate financial institution (for example a pension fund, the German 'Pensionskassen' or an investment fund). This financial institution receives the contributions, invests them and pays out the retirement benefits.⁴

Third, two archetypes of pension frameworks can be distinguished in Europe.¹⁴ In the first archetype (hereafter, archetype I), the IORP is an independent legal entity, at some distance from the employer, with full recourse to own funds. The IORP has up-front provisions on its balance sheet to bear biometric risks or to guarantee a certain investment performance or level of benefits. In the second archetype (hereafter, archetype II), the sponsor and the IORP are closely related and the IORP may have been set up by the sponsor. The sponsor provides the ultimate pension security to its employees and stands ready to supply financing in the event of an adverse shock to the IORP.³ Most Member States have (a combination of) both archetypes.

The fourth and final preliminary remark concerns the fact that pension schemes can be either of a Defined Benefit (DB) or a Defined Contribution (DC) nature. At a general level, there is a common understanding of what constitutes DB and DC pensions. In a DB pension plan, the benefits to be delivered at retirement are predefined in the accumulation phase, and are usually based on an employee's final or average pay and the length of service. In a DC pension plan, contributions paid by employers (and/or employees), rather than the benefits to be delivered at retirement, are defined in any particular year of employment; the accumulated pension assets (and, therefore, the actual benefits that can be delivered at retirement) depend on the level of contributions and the financial performance of the investment of those contributions.¹⁵ The new EU Member States are mostly DC-orientated, whereas DB schemes dominate the Anglo-American world and much of continental Europe including the Netherlands, Germany, Sweden and Switzerland.¹⁶

Legal status of an IORP

Having said this, let us now take a closer look at the Directive. Article 6 of the Directive defines an IORP as 'an institution, irrespective of its legal form, operating on a funded basis, established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity on the basis of an agreement or a contract agreed individually or collectively between the employer(s) and the employee(s) or their respective representatives, or with self-employed persons, in compliance with the legislation of the home and host Member States, and which carries out activities directly arising therefrom'.

An IORP must, pursuant to the IORP Directive, be limited to activities in connection with retirement benefits and related activities. The definition of retirement benefits in the Directive for this purpose is a broad one. It includes labour-related retirement benefits in the form of payments during the entire

(remaining) life, but also temporary benefits or lump sum benefits. Under the definition of retirement benefits thus also fall benefits that – for example – would not qualify as retirement benefits within the context of the Pension Act in the Netherlands.¹⁷ Furthermore, this broad definition makes clear that an IORP cannot be an institution that operates on a *pay-as-you-go* basis. This is explicitly confirmed by Article 2 para 2(c) IORP. Furthermore, Member States are free to choose the legal form of an IORP. This in contrast to the Life Assurance Directives, in which the legal form is prescribed.¹⁸

Another feature is that the IORP needs to be independent from the sponsoring undertaking (mostly the employer). The independence of the IORP with the contributing undertaking is outlined in Article 8 IORP. This article stipulates that each Member State shall ensure that there is a legal separation between a sponsoring undertaking and an institution for occupational retirement provision in order that the assets of the institution are safeguarded in the interests of members and beneficiaries in the event of bankruptcy of the sponsoring undertaking. This legal separation can be carried out in numerous ways, but the largest degree of independence between the employer and the IORP is of course reached when the IORP is a separate legal entity. However, that is no guarantee against a possible bankruptcy of the IORP *itself*. In order to further protect the assets of the funds, Member States had several possibilities. There are two countries (Germany and the United Kingdom) that have implemented a statutory insolvency protection institution. Another possibility is that the IORP can appoint a depositary or a custodian (such as the premium pension institution in the Netherlands). Article 19 of the Directive, however, does not require the appointment of depositary/custodian. The CEIOPS¹⁹ has compared the approaches taken by Member States to the use of custodians by IORPs. As expected, divergent approaches exist in relation to the appointment of a custodian and the kind of body that is appointed to fulfil this role, including the functions that it performs.¹³

Relationship with insurers

When implementing the Directive, some Member States faced the difficulty of maintaining the level playing field with other financial institutions that operate on the market for occupational pensions via group contracts, that is, life assurance companies. Such companies are regulated at Community level by the life assurance Directives. These Directives entail *inter alia*, actuarial principles, solvency margins, technical provisions, supervision and the general exercise of the business. These provisions must under no circumstances be applied to IORPs that *guarantee* the final pension. In other words, where the services of IORPs resemble those offered in group contracts – for example, where the IORP offers a financial guarantee itself – similar rules to those set out in the life assurance Directives are suggested for own capital requirements (Article 17 IORP).⁵ In the Netherlands and Germany, this is the case for the ‘Pensio(e)nfonds’ and ‘Pensionskassen’ (archetype I). New problems can arise when the re-cast Directive on the taking-up and pursuit of the business of Insurance and Reinsurance comes into force.²⁰ This Directive, also known as Solvency II, replaces all the existing 13 Directives in the insurance and reinsurance sector and adds new solvency provisions. The framework of Solvency II follows a similar structure to that of the Basel II banking framework with the use of a three-pillar system. Several Member States have indicated that Solvency II should not be applied to pension funds. Compared to insurance companies, most (traditional) Article 17 IORP pension funds have a long-term perspective and additional security mechanisms that they can apply to recover deficits.

Nonetheless, if a Member State considers that greater consistency must be implemented in the prudential treatment of IORPs and life assurance companies, it should be able to apply certain prudential provisions of the Directive to the occupational pension business of life-assurance companies. This option is given to Member States (Article 4 IORP). The Netherlands has not made use of this possibility. France has (see below). According to the Dutch government, life

assurance companies already have sufficient possibilities to work cross-borderly. The IORP Directive would add nothing to this specific aim.²¹ Moreover, an important disadvantage of the application of Article 4 is the obligation to ringfence (see below), manage and organise all assets and liabilities corresponding to the said business separately from the other activities of the insurance undertakings, without any possibility of transfer. This can be a difficult, costly and long-lasting exercise for the company in question. The question can even be raised as to whether the correct implication of Article 4 must lead to the obligation of an insurer to set up a new legal entity. It can be argued that no other possibilities than this would exist. In our opinion, this is not the case. The original proposal required – in contrast to the final adopted text – that the relevant assets and liabilities are managed ‘in a separate legal entity’.⁵ This is confirmed in practice. France has applied Article 4 IORP to insurance companies. This country has no IORPs.

Finally, the *level playing field* is reached by the fact that every company can set up an IORP. IORPs can even be subsidiaries of assurances companies.

Ringfencing

The concept of ‘ringfencing’ is a problematic one. Ringfencing is undefined in the Directive. It has no specific meaning in EU-law.²² It could mean any of a range of techniques for distinguishing, segregating, or separating one set of assets, liabilities or activities of operations from another. These include methods for insuring that particular assets and liabilities can be identified and traced with ease, as well as techniques for protecting one set of assets from the economic fate of the other, such as providing them with a privileged status in the case of bankruptcy.²² The concept of ringfencing is found in several parts of the Directive.²³ The CEIOPS found that ringfencing can have different meanings in Member States’ own legal frameworks.¹³

Especially in the Netherlands, ringfencing played an important role while implementing the Directive. The Netherlands implemented the

Directive in 2005 in the Pension Act.²⁴

Traditional Dutch ‘Pensioenfondsen’ (such as the ‘Algemeen Burgerlijk Pensioenfonds’) are archetype I IORPs. In 2009, the Dutch will introduce another IORP, an archetype II, the premium pension institution (hereafter, PPI).²⁵ Traditional Dutch pension funds are forbidden by law – in contrast to the PPI – to ringfence between pension schemes. There can be no legal separation between the assets of, for example, scheme A and scheme B. This leads to solidarity between all the beneficiaries. Of course, the ban on ringfencing also has its disadvantages, especially when an IORP wants to operate on a cross-border basis. The solidarity is, however, a condition for the compatibility of the (Dutch) compulsory membership of pension schemes to pension funds with EU law. The European Court of Justice (ECJ) held in several judgments that the compulsory membership is not contrary to EU competition law.²⁶ Moreover, the ECJ emphasised the social function fulfilled by the fund, which relieved pressure on the first pillar regime and shifted the burden to the second pillar. The granting of an exclusive right to manage an industry-wide pension scheme did not infringe Article 82 EC (abuse of a dominant position) and the sectoral scheme could benefit from the public benefit exemption of Article 86(2) EC.¹

Cross-border activity

One of the most interesting and most complicated issues concerns the cross-border activity of an IORP. Many Member States had severe difficulties with the implementation of Article 20 IORP. Let us start by citing the first two paragraphs of this Article:

1. Without prejudice to national social and labour legislation on the organisation of pension systems, including compulsory membership and the outcomes of collective bargaining agreements, Member States shall allow undertakings located within their territories to sponsor institutions for occupational retirement provision authorised in other Member States. They shall also allow institutions for occupational retirement provision authorised in their territories to accept sponsorship

by undertakings located within the territories of other Member States.

2. An institution wishing to accept sponsorship from a sponsoring undertaking located within the territory of another Member State shall be subject to a prior authorisation by the competent authorities of its home Member State, as referred to in Article 9(5). It shall notify its intention to accept sponsorship from a sponsoring undertaking located within the territory of another Member State to the competent authorities of the home Member State where it is authorised.

We will discuss separately some relevant elements of this article and some situations that are *not* covered by this article. It is remarkable that Article 20 does not record the role of the branches and subsidiaries of an IORP, nor the role of IORPs in third countries. It also keeps silent about the difference between the activities of an IORP performing services ex Article 49 EC and the activities of an IORP permanently established in another EU country (Article 43 EC).

National social and labour legislation

Under the Directive, when IORPs operate cross-border, the host country's social and labour law must be applied to host country beneficiaries. This means that the prudential framework of the home country should consider the requirements mentioned in national social and labour law. As every Member State has sovereign autonomy to determine the contents of its social and labour law,²⁷ this can lead to differences between local IORPs and cross-border IORPs. On top of this, however, there is a more fundamental problem: when is an IORP a local IORP or a cross-border IORP? Article 20 seems *prima facie* clear: when a sponsoring undertaking is located in a (Member) State other than the IORP, the IORP operates cross-borderly. In this case, the IORP must seek the permission of the competent authorities, and is held to apply the national social and labour legislation of the Member State whose social and labour law relevant to the field of occupational pension schemes is applicable to the relationship between the sponsoring undertaking and members.²⁸ How do we determine which social and labour law is relevant? Does it concern the

country (must it be a Member State?) where the sponsoring undertaking has its seat? In that case, must it concern its real seat or its incorporated seat? Or are other factors decisive? We will try to answer these and related questions.

Nationality of the scheme

In our view, the difference between the location of establishment of the sponsoring undertaking and the IORP is not decisive enough to determine the possible cross-border activity. What is decisive is the difference between the 'nationality of the pension scheme' and the location of the IORP. Let us illustrate this with some examples, starting with a small detour. Suppose that an Irish IORP wants to operate a pension scheme for sponsoring undertaking Nokia. This company, of course, has branches and subsidiaries across the world, but its head office is in Finland. In Finland, the incorporation theory prevails. According to this theory, the law governing the activities of a company is the law of the state in which the company has been incorporated.²⁹ This contrasts to the real seat theory. For example, Hungarian company law is grounded in the 'real seat' theory, according to which a company must comply with the full requirements of company law applicable in the State in which it has its real seat. As Advocate-General Maduro pointed out, '[t]aking this theory to its full extent, Hungarian company law (...) prohibits the 'export' of a Hungarian legal person to the territory of another Member State. While it may be possible for a company constituted under Hungarian company law to pursue economic activities in another Member State or establish a subsidiary there, the operational headquarters must remain in Hungary'.³⁰ This can be contrary to the free movement of establishment and/or services. The real seat theory has – for this reason – been practically pronounced 'dead',³¹ however not with regard to financial institutions.

Having said this, let us return to the matter at hand. The Irish IORP plans to operate a pension scheme from Nokia. However, it concerns a branch of Nokia located in Dublin. The nationality of all the beneficiaries is Irish. Is the

Irish IORP now planning to operate cross-borderly, and does it need permission from the competent authorities? According to the definition of Article 20, the answer must be affirmative. After all, Nokia has its headquarters in Finland and branches do not possess separate legal personalities. This holds true for branches of 'normal' companies³² and for financial institutions.³³ Is then an Irish IORP that is executing a pension scheme for Irish workers always a cross-border IORP? Or, in the reverse situation, is a German IORP, with a branch in the Netherlands, a cross-border IORP when the sponsoring undertaking is established in the Netherlands? According to Article 20, the answer is negative. After all, branches of the 'parent' body can be 'established' *ex* Article 43 EC in another Member State. However, they are a part of the IORP and have no single legal personality.³⁴ Is the IORP then 'established' in the home *and* the host (Member) State? We will explore this question below. We will find that (1) the 'nationality of the scheme' and (2) the seat theory are decisive factors in determining the possible cross-border activity.

First, the EC Convention on the Law Applicable to Contractual Obligations determines the law applicable to the pension scheme.³⁵ Article 3(1) of that Convention states that a contract shall be governed by the law chosen by the parties. The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice, the parties can select the law applicable to the whole or only a part of the contract. However, Article 6 of the Convention determines that notwithstanding the provisions of Article 3, in a contract of employment a choice of law made by the parties shall not have the result of depriving the employee of the protection afforded to him by the mandatory rules of the law that would be applicable under paragraph 2 in the absence of choice. In other words, the employer and the employee, who together conclude a pension agreement, can or cannot choose the law applicable to the scheme. In either case, the employee cannot be deprived of the protection offered (a) by the law of the

country in which the employee habitually carries out his work in performance of the contract, even if he is temporarily employed in another country, or (b) if the employee does not habitually carry out his work in any one country, by the law of the country in which the place of business through which he was engaged is situated, unless it appears from the circumstances as a whole that the contract is more closely connected with another country, in which case the contract shall be governed by the law of that country.

Second, what is of relevance is the location of the IORP. The Directive defines the home Member State of the IORP as the Member State in which the institution has its registered office *and* its main administration or, if it does not have a registered office, its main administration.³⁶ Clearly, the Directive thus follows the real seat approach, as do most Directives regarding other financial institutions (for example banks,³⁷ assurance companies³⁸). This means that an IORP established in the Netherlands according to Dutch (company) law cannot transfer its real seat to another Member State without losing the IORP passport (secondary establishment). Of course, a Dutch company can for example establish an Irish IORP in Dublin (a Private Pension Fund), but then an Irish permission is needed (primary establishment) according to Irish (company) law.

Services versus establishment

For an IORP, there are *prima facie* several ways to operate a 'foreign' pension scheme. By making use of the provisions of services (Article 49 EC), it can operate from its home state, or *via* a branch in another Member State. It can also permanently establish a subsidiary in another Member State (establishment, Article 43 EC).³⁹ Here we face another difficulty. Within, for example, the framework of the new insurance Directive Solvency II, a 'branch' means an agency or branch of an insurance or reinsurance undertaking that is located in the territory of a Member State other than the home Member State. In addition, Article 143 of Solvency II reads that any permanent presence of an undertaking in the territory of a Member State

shall be treated in the same way as an agency or branch, even if that presence does not take the form of a branch or agency, but consists merely of an office managed by the undertaking's own staff or by a person who is independent but has permanent authority to act for the undertaking as an agency would.⁴⁰ These definitions stem from relatively old case law.⁴¹

As stated above, Article 20 IORP does not deal with branches and/or any difference between establishment and services thereof. In this respect, the 'normal' free movement provisions and case law apply. This point has also been made by Marshall and Butterworth.² In the case of Gebhard, the ECJ found that a service provider could have an office if it were necessary to perform the services in question, without coming under the provisions relating to the right of establishment. Whether or not the provision of services is temporary is to be determined in the light of its duration, regularity, periodicity and continuity.⁴² The Commission notes, in relation to banks that 'On the basis of this case-law,⁴³ an employee of a credit institution coming to work within the territory of a Member State in order to carry out a limited number of specific tasks in connection with existing customers could, therefore, have the infrastructure necessary to perform these tasks without the bank being deemed to be "established" within the meaning laid down by Community law. If, on the other hand, he went beyond the bounds of these specific tasks by using that "*pied-à-terre*" to approach nationals of the host Member State, for example to offer them banking services as a branch would do, the bank could fall within the scope of the right of establishment.⁴⁴ This reading of the Commission seems plausible. However, in most financial Directives (before and after Gebhard, such as Solvency II), the distinction does *not* seem to be taken into account. Any physical presence of the institution outside its home state falls under the provisions of establishment. In the case of an IORP, however, we must stick to the Gebhard criterion. This can lead to confusion. When there is a lack of any secondary legislation, permanent establishment (within the meaning of Article 43 EC) of an

'infrastructure' (within the meaning of Gebhard) seems a *contradictio in abjecto*. Of course, it is commonly known that it is not easy to draw the line between the concepts of provision of services and establishment.⁴⁵ In the area of financial services, it seems even harder. This is especially true of recourse to independent intermediaries.⁴⁶

Finally, an IORP can establish a subsidiary in another Member State, but this seems to serve no purpose. The subsidiary cannot profit from the same IORP passport as its parent.

Conclusion

In our view, a cross-border activity occurs when the nationality of the scheme (for example German) differs from the location of the IORP (for example Dutch). It does not seem to be the intention of the Directive that Article 20 should apply when all the members and the institution itself are 'established' in the same country.⁴⁷ This view, also followed by the Dutch government, is not entirely uncontroversial. As the CEIOPS report shows, eight EU Member States do not take the 'nationality of the scheme' into account, but regard the location of the sponsoring undertaking as a decisive factor in assessing whether an activity is cross-border or not.¹³ If the sponsoring undertaking is based in a different country than the IORP, a cross-border case is identified. Two Member States take the location of the members of the scheme into account. However, this aspect is only assessed in combination with other criteria, that is, the applicable social and labour law or the location of the sponsoring undertaking. A few Member States indicate that they use other factors. Eleven Member States share the Dutch view.¹⁷

IORPS IN SOME MEMBER STATES

In this section, we will discuss the situation in the Member States that have developed a new vehicle on the basis of the Directive (the Netherlands, Luxemburg, Belgium) and/or seem an attractive location for a future IORP (Ireland). A few words will also be said about two large EU economies: France and Germany. Finally, some other Directives that apply to pensions are mentioned. First, however, we need to address a

recent development. As described above, pension schemes can be either of a DB or of a DC nature. Recently, there has been a shift towards DC schemes. This shift explains the recent efforts made by some Member States.

The shift to DC

From a global study by Mercer (2008), it becomes clear that most employers who offer pension schemes to supplement government-financed pension systems do so on the basis of DC (fixed contribution) or a hybrid approach.⁴⁸ This research shows that this is the case with 68 per cent of the investigated companies. Potential DC markets are 'real' DC countries (such as the EU Member States Hungary, the Czech Republic, Poland and Slovakia), but also the United States. The diagram shows all the factors together. It has to be noted that, for the time being, it is, of course, not clear how the credit crunch will influence these Figure 1.

The Netherlands

As already mentioned, the Dutch Treasury, together with the Ministry of Social Affairs, issued at the beginning of 2009 a bill that

introduces⁴⁹ a new financial institution: the PPI. The PPI is based on the IORP Directive and is an archetype II IORP. The PPI can have some traditional Dutch and European legal forms, and can be characterised as a *sui generis* construction. It bears a resemblance to an investment company, but is also has characteristics of an insurance company, an investment fund and a traditional Dutch pension fund.⁵⁰ However, the PPI has no solvency requirements and has very low capital requirements (technical provisions). This is because of the fact that a PPI can operate DC arrangements and even some DB arrangements, as long as it is clear that the PPI itself cannot guarantee the benefits or underwrite the risks. An advantage of the PPI is therefore its simplicity, transparency and flexibility. It profits from a 'weakness' in the Directive, namely, the fact that the national labour and social law of another Member State need to be respected. As most countries are DC-orientated and in most EU/EER Member States the plan sponsor is the employer, and the employer is by social and labour law obliged to guarantee a given investment performance or a given level of benefits, the IORP does not need to underwrite

Figure 1: Retirement – Prevalence and types of supplementary plans.

the risks. For cross-border purposes only, an archetype II IORP could suffice, or so seems to be the reasoning of the Dutch government.

Belgium

Belgium implemented the Directive by adopting a new legal framework. An Act of 27 October 2006⁵¹ on the supervision of IORPs defines the legal structure, the organisation and the functioning of a new special-purpose vehicle.⁵² The then Prime Minister of Belgium Guy Verhofstad organised a true 'road show' to promote the vehicle.⁵³ This new vehicle is called the 'Organization for the Financing of Pension' (OFP). All new Belgian pension funds have to be incorporated as an OFP. All existing Belgian pension funds (which are most often structured as not-for-profit entities) have to transform into an OFP before 1 January 2012. The OFP must consist of at least two bodies: a general assembly and a board of directors. The sponsoring undertakings whose pension plans are operated by the OFP are members of the general assembly. The general assembly has the overall supervision and oversight responsibility, and may be granted broad powers. The OFP must have at least one operational body: the board of directors. The latter defines the general policy of the OFP and is responsible for the operational activities of the OFP. An interesting and attractive feature is the so-called social committees. In order to respect the local social and labour regulation, one or more social committees may be set up to allow the OFP to meet the requirements of the host country's social and labour legislations applicable to the pension plans that it operates.

The OFP is an archetype I IORP, it underwrites the liability to cover against biometric risk, and can guarantee a given investment performance or a given level of benefits. The OFP legislation contains a special section on cross-border activities. A cross-border activity is defined as 'the activity which, for an institution for occupational retirement provision authorised in a Member State, consists in managing occupational pension schemes which, in respect of the provisions applicable to the relationship between the sponsoring undertaking

and members, are subject to the social and labour legislation of another Member State.'⁵⁴

Luxembourg

The Luxembourg pension laws were introduced in 1999 and 2000, with the aim of creating pan-European pensions and anticipating the Directive. The legislation has focused on the establishment of three pension funding vehicles: the Pension Savings Company with Variable Capital (SEPCAV), the Pension Savings Association (ASSEP) and the CAA (*Commissariat aux Assurances*) pension funds.⁵⁵ The SEPCAV shares similarities with another vehicle from Luxembourg, the so-called SICAV investment fund. The SEPCAV is a company with limited liability in which the value of the benefits is equal to the number of shares multiplied by the value of the shares. The SEPCAV can only be used for DC schemes and is an archetype II IORP. The ASSEP is a vehicle with an associative structure that can be used for both DC and DB schemes. Its features are similar to those of non-profit making associations. The CAA pension fund offers flexibility in the form of a vehicle for DCs, DBs and/or supplemental benefits in case of death or disability of members. As Luxembourg is already home to several investment funds, the spillover to pension vehicles can easily take place.

Ireland

In Ireland, relatively few changes were required to bring the Pensions Act into line with the Directive. The Pensions Act contains the main implementing framework provisions, which are supplemented by a number of Regulations that set out more detailed changes in a number of areas including cross-border provisions, trusteeship and investment requirements. There is no legal obligation for a company to set up a company pension plan. The legal form of these pension schemes in Ireland is the trust. The scheme has no legal personality. Legal responsibility for the scheme rests with the trustees. The assets of the pension scheme are legally required to be separate from those of the employer. In this respect, the requirements for ringfencing are met. Together

with the favourable tax treatment, the Irish trust seems an attractive vehicle for cross-border IORPs.⁵⁶

Germany and France

Although these countries have not developed new IORPs since the Directive, it seems noteworthy to highlight some typical pension aspects. In France, the occupational retirement provision is treated as a line of insurance business. To the insurances companies concerned, France applied Article 4 IORP. The market for second pillar occupational pensions in France is still relatively small, as a result of generous state pensions and statutory PAYG schemes such as AGIRC–ARCCO. The main types of scheme are insured pension plans and company savings plans. Insurance-based occupational pension plans entail DB plans and collective DC plans. Company savings plans are comprised mainly of ‘Plans d’épargne entreprise’ (PEE) and ‘Plan d’épargne retraite collectif’ (PERCO). PEE, established in 1967, is a short-term savings plan and hence can be viewed as a near-pension product. PERCO, created in 2003, is largely based on the same principles as PEE, but investment is until retirement (with early withdrawal possibilities). Foreign IORPs can fulfil only a small role (in the third pillar) on the French market.

In Germany, there are two institutions for occupational retirement provision that fall under the scope of the IORP Directive, that is, ‘Pensionskassen’ and ‘Pensionsfonds’. In addition to these two types of occupational pensions, there are three other types, namely, ‘Direktusage’ (book reserves), ‘Unterstützungskassen’ (support funds) and ‘Direktversicherung’ (direct insurance). However, these institutions do *not* fall under the scope of the Directive. Potentially, IORPs can operate on the German market, as long as German law recognises them as one of the above-mentioned German types.⁵⁷ German law does not mention a foreign IORP as a possible operator of German pension schemes. This seems questionable in the light of the compatibility with the freedom of services and establishment (Articles 43 and 49 EC).

Another recent development in Germany is the increasing popularity of the so-called ‘Contractual Trust Arrangements’ (CTA, also known as the ‘Treuhandsmodell’). The CTA is, however, not an IORP. Fundamentally, it is a simple entity. The starting point is an internally or book reserve-funded programme. The pension assets are fully integrated with company business assets.⁵⁸ A company may, however, choose to ‘ earmark’ certain business assets as being held to correspond to the pension liabilities. Basically, these companies outsource their pension obligations using a CTA. The CTA becomes increasingly popular in German companies as a way of financing their pension schemes. A CTA may even qualify as a ‘trust or an equivalent of a trust’ under US Internal Revenue Code Section 404A if additional conditions are met.⁵⁸

Other directives

As already mentioned in the introduction, the Directive touches on social matters, which are only partially harmonised. Article 42 EC allows for adopting measures in the field of social security to provide for freedom of movement for workers who are Member State nationals and for their dependants. The principal regulations adopted under this provision is Regulation 1408/71.⁵⁹ Statutory schemes such as the British SERPS⁶⁰ and the French ARRCO and AGIRC are covered by this regulation⁶¹ (whether or not they include a funded part), but non-statutory schemes (established by collective agreements) can also be included in the scope of this regulation.⁶² Directive 79/7⁶³ on equal treatment of men and women also applies to statutory schemes. Directive 86/378⁶⁴ (amended by Directive 96/97)⁶⁵ implements the principle of equal treatment for men and women in occupational social security schemes, as does Directive 98/49,⁶⁶ which safeguards the supplementary pension rights of employed and self-employed persons moving within the community (this protection concerns any voluntary and compulsory occupational pension scheme. Directive 2000/78⁶⁷ establishing a general framework for equal treatment in employment and occupation also applies to occupational pensions. The

proposal for a Directive on the portability of supplementary pension rights covers all supplementary pension schemes in which there is a link with employment including book reserve and *pay-as-you-go* schemes.⁶⁸ The proposal, meanwhile, has been heavily amended and arranges for everything *but* portability.⁶⁹

Conclusion

On the basis of the IORP Directive, several other European countries, such as Belgium (OFP), Luxembourg (Pension Savings Company with Variable Capital, SEPCAV and ASSEP) and Ireland (Private Pension Fund, PPF), have established new IORPs. In view of this international trend, it is therefore important for a Member State such as the Netherlands to maintain a strong international position in the pension sector.

The particular interpretations chosen by the mentioned institutions in other European countries differ from each other in a number of respects. The Dutch PPI is only directed at contribution agreements without term life insurance or guarantee, whereas the other above-mentioned institutions (with the exception of the SEPCAV) also may offer benefit agreements and in certain cases also may insure risks. Some other differences are that the PPI, as opposed to the above-mentioned institutions, in certain cases determines that the assets have to be placed with a separate custodian.

FINAL REMARKS

In September 2008, the European Commission issued a 'broad consultation' on the possible review of certain aspects of the Directive.⁷⁰ The purpose of this broad consultation is 'to collect the views from all stakeholders concerned on whether they believe that, from an internal market perspective, a further harmonisation of the solvency regime for IORPs covered by Article 17 of the IORP Directive and IORPs operating on a cross-border basis is desirable or not and what the reasons are for expressing that view.'⁷⁰ An important question that Member States have to answer is that of whether Solvency II should apply to pension funds.⁷¹ Most Member States

will answer this in the negative. Apart from this, an important issue to clarify in the Directive is the concept of cross-border activity. The lack of clarity about this concept forms an obstacle for institutions to be active in other EU Member States. Another hindrance for cross-border activity is the extent to which Member States can determine the contents of their national labour and social legislation. In some cases, even prudential requirements are considered to be social and labour law. Without a single, (more) harmonised interpretation of these concepts, a true pan-European pension fund seems far away. Allegedly, differences in labour and social laws across Europe have already slowed down several pension funds to go cross-border.⁷²

Although the cross-border competition for locating IORPs started to have some impact before the credit crunch, especially in the Benelux and Ireland, it is a fact that there is only still a very small number of IORPs providing cross-border services. At the end of 2008, around 70 cases of cross-border activity existed in the EU/EER, across nine home states and some 18 host states.⁷³ The extent to which the credit crunch will have an impact on the pension reform remains to be seen. It could be expected that the shift from DB to DC schemes will become even larger.⁷⁴ It could furthermore be expected that pension funds will simplify their investment strategies and apply a 'back to basics' approach to risk management in the future. Of course, this can have consequences for cross-border activity. What is already clear is that the financial crisis has dealt a heavy blow to private pension systems. Between January and October 2008, private pensions in the OECD area have registered losses of nearly 20 per cent of their assets.⁷⁵ However, although the short-term impact is clearly negative, pension funds, by their nature, mostly work with long time horizons, and their performance should be evaluated on this basis. If one looks at returns over the past 15 years – up to October 2008 – a positive picture still emerges. For example, the average, annual real rate of return of pension funds was 8.5 per cent in Sweden, and 6.1 per cent in both

the United States and the United Kingdom over this period.⁷⁵

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- 2 Marshall, J. and Butterworth, S. (2000) Pensions reform in the EU: The unexploded time bomb in the single market. *Common Market Law Review* 37: 739–762.
- 3 See for an understanding of these concepts, CEIOPS (2008) *Survey on fully funded, technical provisions and security mechanisms in the European occupational pension sector*, March.
- 4 According to the EFRP (2005): *EFRP response to the European Commission Green Paper confronting demographic change* www.efrp.org.
- 5 European Commission, COM (2000), p. 507.
- 6 That is before the credit crunch had its impact, see *infra*, para 4.
- 7 For an overview of the developments and EU-initiatives until 2000, *supra*, note 1.
- 8 This was one outcome of the 6th European Pension Debate, organised by the University of Tilburg (2009), the Netherlands, April, www.uvt.nl/ccp/epd.
- 9 O.J. 2003, L 235/1.
- 10 Although in 2006 the Commission send reasoned opinions to Belgium, Cyprus, the Czech Republic, Finland, France, Italy, Lithuania, Slovakia, Slovenia, Spain and the United Kingdom for not having written the Directive into their national laws, or for having done so only partially.
- 11 Italy, United Kingdom and the Czech Republic.
- 12 This issue was not a 'key aspect' as defined by CEIOPS, but was a difficult 'nut to crack' for the Dutch government during the implementation of the IORP Directive.
- 13 The other key aspects, as defined by CEIOPS, are the following: exemptions for small institutions, information to be provided to members and beneficiaries, reporting requirements, 'fully funded' and the calculation of technical provisions, insolvency protection institutions, subordinated loans, investment regulations and custodianship. See: CEIOPS (2008) *Initial review of key aspects of the implementation of the IORP Directive*, March.
- 14 *Supra*, note 3. The reality is more diverse. Some pension funds only partially underwrite the liabilities themselves, together with the plan sponsor and/or the employees.
- 15 See: EFAMA (2008) *Defined-contribution pension schemes, Risks and advantages for occupational retirement provision*, www.efama.com.
- 16 Clark, G.L. (2000) *Pension Systems: A Comparative Perspective*. Oxford: Oxford University Press.
- 17 'Explanatory Memorandum' of the Dutch PPI Act, Dutch Acts of Parliament ('Kamerstukken'), nr. 31891, 3, 2008–2009.
- 18 In the case of the United Kingdom: 'incorporated companies limited by shares or by guarantee or unlimited', 'societies registered under the Industrial and Provident Societies Acts', 'societies registered or incorporated under the Friendly Societies Acts', 'the association of underwriters known as Lloyd's'.
- 19 CEIOPS is the Committee of European Insurance and Occupational Pensions Supervisors. It was established under the terms of the European Commission Decision 2004/6/EC of 5 November 2003 and is composed of high level representatives from the insurance and occupational pensions supervisory authorities of the European Union's Member States. The authorities of the Member States of the European Economic Area also participate in CEIOPS.
- 20 COM (2008), p. 119.
- 21 Dutch Acts of Parliament ('Kamerstukken II'), 2004–2005, 30104, nr. 3, p. 7.
- 22 Arnot, S. (2004) *Legal Commentary on the Pension Funds Directive [dir. 2003/41/EC]*, EFRP.
- 23 Article 3 (operation of first and second pillar); Articles 4 and 7, (separation from insurance business); Article 16(3) (supporting the full funding requirement for cross-border schemes); Article 18(7) (application of specific investment rules in the event of cross-border) and Article 21(5) (request from host state to home state for ring fencing).
- 24 Wet van 19 januari 2006, houdende wijziging van de Pensioen- en spaarfondsenwet en enige andere wetten in verband met de implementatie van richtlijn nr. 2003/41/EG van het Europees Parlement en de Raad van de Europese Unie van 3 juni 2003 betreffende de werkzaamheden van en het toezicht op instellingen voor bedrijfspensioenvoorziening (PbEG L 235/10).
- 25 At the time of writing of this article, not yet in force. See: www.minfin.nl.
- 26 Cases C- 67/96, *Albany*, C-180–184/98, *Pavlov*.
- 27 To the extent that national measures must be in conformity with the Treaty (for example Article 10 EC, loyal cooperation) and that Member States may not misuse EC law. In other words: 'There is no nucleus of sovereignty that Member States can invoke as such against the Community'. See: Lenaerts, K. (1990) Constitutionalism and the many faces of federalism. *American Journal of Comparative law*, 38.
- 28 Article 6(j) of the Directive, the definition of 'host Member State', O.J. 2003, L235/10.
- 29 Edwards, V. (1999) *EC Company Law*. Oxford: Oxford University Press.
- 30 Case C-210/06, *Cartesio* (opinion).
- 31 Although, surprisingly, the Court held in its judgment (C-210/06, *Cartesio*) that Articles 43 EC and 48 EC are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State while retaining its status as a company governed by the law of the Member State of incorporation. This judgment stands in clear opposition to the opinion of the Advocate General.
- 32 For example, case C-210/04, *FCE*.
- 33 'A branch is a place of business which forms a legally dependent part of an insurance undertaking.' See: 'Commission interpretative communication, Freedom to provide services and the general good in the insurance sector' (O.J. 2000, C 43).
- 34 See also Article 1 of the 'Investment Services Directive', Directive 93/22/EEC, O.J. 1993, L 141.
- 35 Rome (1980). The treaty is replaced by the Rome I-regulation, which will be applicable from December 2009. Regulation 593/2008, O.J. 2008, L177.
- 36 Article 6(i) IORP-Directive, O.J. 2003, L235/10.
- 37 Directive 2006/48/EC (O.J. 2006, L 177/1).
- 38 Solvency II, *supra*, note 20.
- 39 Advocate-General Darmon wrote in point 3 of its conclusion in the case of *Daily Mail*: 'Establishment means integration into a national economy. Thus, it is not contested that establishment within the meaning of the Treaty involves two factors: physical location and the exercise of an economic activity, both, if not on a permanent basis, at least on a durable one.' See: Case 81/87, *Daily Mail*, (opinion).
- 40 See also Article 1 of the 'Investment Services Directive', Directive 93/22/EEC, O.J. 1993, L 141. Ferrarini, G. (1994)

- Towards a European law of investment services and institutions. *CMLRev* 31.
- 41 Case 205/84, *Commission v Germany*.
- 42 Case C-94/55, *Gebhard*.
- 43 The *Gebhard* case.
- 44 See: 'Freedom to provide services and general good', Interpretative Communication, *op.cit*, note 40.
- 45 Van Meerten, H. *et al* (2008) National report of the Netherlands on the new services directive. In: H.F. Koeck and M. Karollus (eds.) *The New Services Directive of the European Union*, Report for, Linz, Austria: FIDE XXIII Congress.
- 46 See: 'Freedom to provide services and general good', Interpretative Communication, *op. cit*.
- 47 See also the European Commission (2005) *Working document for the meeting on the transposition of the IORP Directive*, Meeting on 19 April 2005 (MARKT/2510/05-EN Or.).
- 48 Titled: 'Benefit & Compensation Plans Around the World'. See: www.mercer.com.
- 49 Into its financial legislation, the 'Wet op het financieel toezicht', pp. 1–30.
- 50 Because the premium pension institution (PPI) explicitly is not a pension fund in which social partners operate a pension scheme solely for their own circle of solidarity, the same requirements do not have to apply to the PPI that apply to pension funds. The PPI does not, for instance, need to have a joint board. The similarities with a so-called UCITS (Undertakings for collective investment in transferable securities, see Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (OJ EC L375), can furthermore be mentioned. It is unmistakable that there are similarities between an IORP and a UCITS. It is not for nothing that Article 2(2), under c of the IORP Directive stipulates that it does not apply to UCITS. The European legislator found that these institutions differ by nature. The PPI has in common with a UCIT that both institutions do not bear underwriting risks. The IORP Directive allows room for this. For the Directive makes a difference between so-called Article 17 IORPs (which are IORPs that do insure) and non-Article 17 IORPs.
- 51 Belgium Law of 27 October 2006 on the supervision of institutions for occupational retirement provision.
- 52 However, initially the solvency requirements remained unclear.
- 53 See also the website: www.invest.belgium.be.
- 54 Article 2(10) of the Directive.
- 55 See also the website: www.lff.lu, ('Luxembourg for Finance').
- 56 For example, *Investment & Pensions Europe* headlined that 'Two Dutch schemes to move to Mercer pan-European vehicle'. This Irish pension vehicle is a master trust, which can be joined by more than one employer. An advisor claimed: 'Its centralised structure will lead to lower operational costs, increased efficiency and better governance.' See: www.ipe.com, 15 October 2007.
- 57 Article 118e (3) of the German Insurance Supervision Law ('Versicherungsaufsichtsgesetz', VAG).
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- 61 Which has been replaced meanwhile by Regulation 883/2004 (O.J. 2004, L160/1).
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- 63 O.J. 1979, L6/24.
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- 66 O.J. 1998, L209/46.
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- 68 COM (2005), p. 507.
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- 70 Ref: Ares (08) 14767, <http://ec.europa.eu>, accessed 3 September 2008.
- 71 *Supra*, para 2.2.
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- 73 CEIOPS, 2008 *Report on Market Developments*. CEIOPS' first report on market developments was published in 2007. This 2008 update covers the period of 18 months to June 2008 and shows a 46 per cent increase in the number of IORPs operating cross-border.
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- 75 For more detail: OECD. (2008) *Pension markets in focus: Special Feature: Private Pensions and the 2008 Turmoil in Financial Markets*, December, Issue 5.

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