Benefits Brief

GROOM LAW GROUP

EU Pension Authority Issues Final Regulations for the New "EU IRA"

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AUTHORS: David Powell

EIOPA, the European Insurance and Occupational Pensions Authority, has issued final regulations on the structure, offering and regulation of the "Pan-European Personal Pension" product or "PEPP". This was an idea broached by the EU back in 2016, the subject of proposed regulations in 2017, and has been the subject of considerable discussion and negotiation in the interim. The publication of these regulations on July 25, 2019, starts the clock running for PEPPs to be offered, with the regulations effective August 14, 2019, and the regulation is to enter into application 12 months after that, upon which the EU countries and their pension regulators (the "competent authorities") are to have put it into effect under local law, and in theory, applications by financial institutions can begin. EIOPA has estimated the time for the first products to be available on the market to be about 2 and ½ years.

The idea behind PEPP is to have a new, voluntary personal pension plan that will offer consumers a mobile, pan-European option to save for retirement. This new product is designed to give savers more choice with competitive products, portability, and consumer protections. It can be offered by a broad range of financial providers including insurance companies, asset managers, banks, certain investment firms, and certain occupational pension funds. Those familiar with the US pension system will recognize a strong resemblance to individual retirement accounts or IRAs. Given the over 8 trillion US dollars currently invested in IRAs – more than the amount held in US employer-sponsored defined contribution plans - this may make the PEPP something financial institutions will wish to follow.

Though arguably watered down from the original proposal, the final regulations describe the specific financial entities that can sponsor (or "manufacture") PEPPs, and provides that a broader group of insurance intermediaries and financial institutions can market PEPPs sponsored by other financial institutions. The terms that must be included in a PEPP contract are also outlined. Generally, a PEPP is to be approved and regulated by an EU competent authority, and upon approval is registered by EIOPA and then can be offered in any EU jurisdiction. Within three years of the regulation, any PEPP must be offered in at least two EU states. The PEPP will provide sub-accounts for the jurisdictions in which it is offered, which will help reflect the relevant tax regimes and treaties with non-EU states.

Investments and Risk Mitigation/Guarantees

PEPP providers may offer up to six investment options to PEPP savers. The investment options are to include the "Basic PEPP", and may include alternative investment options. PEPPs may offer options that include longevity protection (coverage of "biometric risks").

The Basic PEPP is the default investment option. It is to provide either (1) a guarantee on the capital which shall be due at the start of the decumulation phase and during the decumulation phase, where applicable (e.g., an annuity), or (2) a risk-mitigation technique consistent with the objective to allow the PEPP saver to recoup the capital. This guarantee was one of the more controversial points of discussion regarding the design of the PEPP. However, in lieu of a guarantee, applicable risk-mitigation techniques may include a provision for gradually adapting the investment allocation to mitigate the financial risks of investments for cohorts corresponding to the remaining duration (i.e., life-cycle funds). Risk mitigation may also include establishing reserves from contributions or investment returns, which can be allocated to PEPP savers in a fair and transparent manner to mitigate investment losses.

EIOPA intends to consult with other EU supervisory authorities and industry to develop draft regulatory technical standards specifying the minimum criteria that the risk- mitigation techniques have to satisfy, taking into account the various types of PEPPs and their specific features, as well as the various types of PEPP providers and the differences between their prudential regimes. EIOPA is to have those draft regulatory technical standards available by 15 August 2020.

If the PEPP provider provides alternative investment options, the PEPP saver, while accumulating in the PEPP, will be able to choose a different investment option after a minimum of five years from entering into the PEPP contract, or, in the case of subsequent changes, after five years from the most recent change of investment option. However, the PEPP provider may allow the PEPP saver to modify the chosen investment option more frequently.

The regulation provides that PEPP investments will be subject to the 'prudent person' rule and provides detail on how that is to be applied. Notably, they also indicate that the prudent person rule should take into explicit consideration the role played by ESG factors in the investment process. The information on ESG factors is to be available to EIOPA, to the competent authorities and to PEPP savers.

Tax advantages of the PEPP will be determined at the national level, as will be minimum and maximum contribution levels. However, the European Commission has already encouraged member states to grant PEPPs the same tax treatment as similar existing national personal pension products, even if they do not match all national criteria for tax relief.

Fees

The costs and fees for the Basic PEPP shall not exceed 1% of the accumulated capital per year. For investments in general, EIOPA is to develop draft regulatory technical standards specifying the types of costs and fees referred to in paragraph 2, having consulted the other EU supervisory authorities where applicable.

Switching

Savers moving between PEPP products is referred to as "switching". The regulations provide rules for such switching. PEPP savers are to have the right to switch to a different PEPP provider located in the same or another member state during the accumulation phase, through a clear, quick and safe procedure. However, PEPP providers are not obliged to provide the switching service for PEPPs where savers are receiving distributions in the form of lifetime annuities.

Saver Changing State of Residence

Generally, contributions while a saver is resident in one EU state are accounted for as being attributable to a state-specific sub-account. After being informed about the PEPP saver's change of residence to another EU member state, the PEPP provider is to inform the PEPP saver about the possibility to open a new sub-account within the PEPP saver's PEPP account and about the timeframe within which such a sub-account could be opened.

Forms of Distribution

PEPP providers are to allow one or more of the following forms of out-payments: annuities, lump sums, drawdown (installment) payments, or a combination thereof.

Key Information Document (KID) and Benefit Statements

The regulation provides specific rules on disclosure of information about the PEPP.

The PEPP Key Information Document ("KID") is to be provided free of charge before the PEPP is entered into. The KID must be accurate, fair, clear and not misleading. It shall provide key information on the terms of the PEPP and be consistent with any binding contractual documents, with the relevant parts of the offer documents and with the terms and conditions of the PEPP. The PEPP provider is also to provide the saver with information on the specific sub-account for the member state of residence of the PEPP saver.

This information may be provided electronically. Upon request, PEPP providers and PEPP distributors must provide free of charge those documents and information on another durable medium, including paper, and notify customers about that right.

PEPP providers are also to prepare a concise personalized document to be provided at least annually during the accumulation phase containing key information for each PEPP saver taking into consideration the specific nature of national pension systems and of any relevant law, including national social, labour and tax law. This is the "PEPP Benefit Statement".

The PEPP Benefit Statement is where information for the PEPP is provided to the saver regarding the PEPP contributions, investments and total amount in the account, as well as a breakdown of all costs. The PEPP Benefit Statement is also to include a personalized projection of pension benefits at retirement, based on assumptions to be developed by EIOPA in consultation with the European Central Bank and competent authorities.

The regulations also provide guidance on reporting by PEPPs to the national authorities.

Other Provisions

The regulations are intended to provide a complete EU-based guidance on regulation of PEPPS. Thus, it also deals with the approval process, reporting to the national authorities, supervision by competent authorities, powers of intervention, requirements regarding cooperation and consistency of application of the regulation, and provisions on complaints by savers.

Final Thoughts

PEPPs have a long way to go before they are offered, with individual country legislation, design and development of products by financial institutions, and approvals by competent state authorities, all to take place before one can actually be purchased. EIOPA has also put together an expert panel from the pension industry and other stakeholders to consider good PEPP design. How PEPPs will fit into the EU marketplace will then be seen. In countries with robust pension savings opportunities and workplace pensions already, it is possible to see them as not adding much value. However, that does not describe all countries. Moreover, trends towards the “gig economy” and more mobile employees also suggest the need for non-workplace and non-country specific products for saving for retirement.

For now, though, the EU has provided a roadmap for both the financial institutions interested in entering this market and a direction to the country regulators to allow it.