PEPP: WHAT NEEDS FIXING?

Europe's population is ageing. In 2060, for every retired person there will be on average only two people of working age, compared to four today. As a result, despite the important reforms carried out by many EU Member States, state-based and occupational pensions will come under increasing pressure. Citizens will need to save more to complement their retirement income from state and occupational pensions.

At the same time, European markets for personal pension products are fragmented and uneven, in some parts of the Union even non-existent. Market fragmentation prevents personal pension providers from maximising economies of scale, risk diversification and innovation, thereby reducing choice and increasing cost for pension savers. Finally, cross-border selling, and the portability of existing personal pensions are very limited.

To address these concerns, the new EU Regulation on a Pan-European Personal Pension Product (PEPP)[1] of June 2019[2] provides citizens with more quality choice when saving for retirement. The PEPP regulatory framework lays down the foundations for a pan-European personal pension market, by ensuring standardisation of the core product features, such as transparency requirements, investment rules, switching right and type of investment options.

The PEPP will be a voluntary third pillar pension product that will complement existing state-based and occupational pension systems, as well as national private pension schemes without replacing or substituting them.

The PEPP is designed to give hundreds of millions of savers in the EU more choice when saving for their retirement and to provide them with more competitive products while ensuring strong consumer protection. PEPP will also create new opportunities for providers to tap into a European-wide single market for personal pensions. This market is estimated to grow from € 0.7tn to €2.1tn over the next decade, assuming tax incentives for PEPP. The new PEPP Regulation is also a key initiative of the European Commission's Plan for an EU Capital Markets Union as it seeks to channel more savings into long-term investment in the EU.

The PEPP Regulation mandates the European Commission to adopt an important number of technical acts (3 delegated acts, 9 regulatory technical standards (RTSs) and 2 implementing technical standards (ITSs)) based on the technical advice or on draft technical acts to be submitted by EIOPA within 12 months after the entry into force of the Regulation.

These technical acts concern in particular the details/presentation of the PEPP key information document (KID) and of the PEPP pension benefit statement (PBS), the specification of costs and fees covered by the 1% fees cap for the Basic PEPP, the minimum criteria for risk mitigation techniques for the investment options, EIOPA's product intervention powers and the content and presentation of additional information for supervisory reporting.

The PEPP Regulation will apply 12 months after the publication of the technical standards. The first PEPPs may appear on the market soon after the entry into application of the Regulation.

The PEPP Regulation does not cover tax aspects. However, the European Commission has recommended[3] Member States to grant PEPP the same tax treatment as is currently granted to similar existing national pension products, (even when not all criteria are fully met) and to exchange best practices on the tax treatment of such products with a view to bringing closer their tax rules, in order to facilitate the portability of such products.

A very challenging monetary environment for the development of savings products and the PEPP

Unlike American savers, European savers are characterized by risk aversion, especially since pension systems are almost exclusively pay-as-you-go systems and not funded though defined contribution plans as in the US.

Moreover, lasting zero or event negative long-term interest rates encourage retail savers to hold funds in standard deposit accounts, such as checking accounts instead of other investment options. In other words, persistent zero interest rates discourage savers from investing in financial investments and encourage preference for liquidity (hoarding). One can observe that retail investors in the EU indeed prefer cash savings over bond purchasing, which do not generate enough return and higher safety. At the same time, the gloomy economic outlook and high levels of equity markets do not encourage equity investment in Europe.

Persistent zero interest rates are « de facto » insufficient for taking risks, eventually blur risk premiums and reinforce the caution of savers to strengthen their risk-free savings mattress.

Guaranteeing the capital of savers in such a monetary environment is really challenging.

---

[1] Based on the European Commission's proposal of 29 June 2017 (Proposal for a Regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP) - COM/2017/0343 final - 2017/0143 (COD)).

[2] Text already adopted by the European Parliament and the Council and published in the OJEU on 25 July 2019.

[3] Recommendation C (2017) 4393 final on the tax treatment of personal pension products, including the PEPP.