



Executive summary
EY
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Study on the feasibility of a European Personal Pension Framework

June 2017



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Executive summary

All EU Member States are facing constant challenges with regard to ageing populations, pension sustainability and adequacy of the pension regimes.

In the context of a challenging economic environment with low rates and different trends in government budgets, anticipating the evolution of pensions only within the framework of state-based and occupational pensions (pillar 1 and 2) does not appear to be sufficient to fill the pension gap. Hence the development of personal pensions (pillar 3) has become a major issue for Member States and European institutions that is likely to continue in the next decade.

Aware of these fundamental challenges, the European Commission has launched a study with EY on the feasibility of a European Personal Pensions framework in the context of the Capital Markets Union (CMU) action plan.

This study was based on the following steps:

- Tax mapping consisting of the identification of tax, social and labour requirements applicable to the available PPPs (1);
- A PPP market overview consisting of the description of the PPP markets in each Member State (2);
- The ranking of the existing personal pension products depending on the level of market penetration, identification of their key features and understanding of the sensitivity of the products vis-à-vis certain key features, in the context of the identification of certain clusters from a tax perspective (2, 3 and 4);
- A technical feasibility assessment (5 and 6): the objectives of the final feasibility assessment (6) based on a preliminary assessment of the PEPP market potential (5) were as follows:
 - assess the product's added value from supply and demand side perspectives,
 - assess the product in comparison to available personal pension products (hereafter "PPPs"),
 - assess their correlative tax legislation;
 - analyse the practical implementation aspects and;
 - evaluate the market potential for such a product (update of the preliminary assessment)

Deliverables	Key findings	Steps
Tax mapping: tax classification trees and tax ID card for each personal pension product	Despite the diversity local regulations, the majority of the personal pension products analysed fall under the same type of tax regime (17 out of 28 Member States have a PPP governed by a similar tax regime) with the following general characteristics: <ul style="list-style-type: none"> - In-payments benefit from tax exemption, mostly through a reduction of the personal income tax base with a limitation on the amount of in-payments qualifying for tax exemption and/or income limitation (19 out of 28 Member States incentivise in-payments); - Out-payments are taxed. 	1

	<p>The main form of out-payments observed is the annuity. However, it should be noted that in most cases, there is no mandatory form of out-payment and the pension saver can choose between different options - mainly between annuities and a lump sum.</p> <p>Another trend observed is that early out-payments are, in most cases, either limited or penalised when there is no limitation.</p> <p>The taxation of the yield during the accumulation phase is not relevant for tax regime classification purposes; most of the products are exempt from tax on the yield.</p> <p>Current PPP tax regimes across the EU show a high level of heterogeneity. However, the most representative overall tax regime is EET/ETT</p>	
<p>Clustering based on PPP features</p>	<p>Four different approaches to the clustering of PPPs were adopted with the aim of identifying common denominators in tax treatment across Member States.</p> <p>Clustering A: The aim was to identify products with the same features (based on 20 questions selected) giving access to tax incentives. Due to the diverse nature of product features, it was concluded that such clustering was not possible.</p> <p>Clustering B: Another clustering operation was performed based on the answers to 17 out of 20 questions selected. This clustering gives the most significant results. It resulted in a cluster of 14 PPPs with 100% common feature requirements to benefit from tax incentives.</p> <p>The other two attempts at clustering (C and D) did not provide relevant results:</p> <ul style="list-style-type: none"> - The results of Clustering C based on a hierarchical clustering approach showed a high level of heterogeneity; - The results of Clustering D are based on the decumulation options allowed and are very similar to the results obtained from Clustering B. <p>As the current PPPs have very diverse tax features, no relevant cluster was identified, notably with respect to the decumulation phase.</p>	<p>4</p>
<p>The market overview</p>	<p>A PPP market description is provided, taking into account: (i) Assets under management (AuM) (ii) the number of PPP holders and (iii) the level of in-payments.</p> <p>Three relationships are identified in this study. While the level of AuM seems to increase with the level of household financial assets, a link also exists between the number of PPP holders and the size of the population. Finally, the level of in-payments is impacted by the household savings rate.</p>	<p>2</p>

	<p>The current development of the PPP market reveals a stark difference between PPPs with a high MPI and other PPPs</p>																			
<p>Products with a high Market Penetration Index (MPI) and their key features</p>	<p>To identify the most successful PPPs, a market penetration index (hereafter referred to as "MPI") was built. This index consists of three dimensions which captures the relative level of capitalization of each PPP (as measured by AuM over household financial assets), the relative level of participation (as measured by number of PPP holders over population) and the relative dynamic of each PPP (as captured by in-payments over household savings).</p> <p>The following products were identified as the five PPPs with the highest MPI:</p> <table border="1" data-bbox="491 750 1289 1070"> <thead> <tr> <th>Ranking</th> <th>Member State</th> <th>coded name</th> </tr> </thead> <tbody> <tr> <td>1</td> <td>Germany</td> <td>Germany Riester</td> </tr> <tr> <td>2</td> <td>Spain</td> <td>Spain IPP</td> </tr> <tr> <td>3</td> <td>Belgium</td> <td>Belgium PP</td> </tr> <tr> <td>4</td> <td>Denmark</td> <td>Denmark RP</td> </tr> <tr> <td>5</td> <td>Austria</td> <td>Austria PZV</td> </tr> </tbody> </table> <p>All of the five PPPs with the highest market penetration identified benefit from a tax incentive on in-payments, with a limitation on the amount qualifying for a tax incentive for four products out of five from 5 different Member States.</p> <p>For four of the five products, out-payments are taxed. For Austria_PZV, it depends on the decumulation option. Decumulation in the form of annuities is a possible option for all the PPPs in the scope of the study, but is mandatory for only one product.</p> <p>Regarding the possibility of early out-payments and the tax regime applied, the regimes of all five products allow for early out-payment which is taxed in all cases, and taxed unfavourably in four cases.</p> <p>Theoretically, the switching of provider within the same Member State is possible for these five products and does not trigger any immediate tax impact at the time of the transfer. Switching to a provider located in another Member State is not possible for two of these products. Nevertheless, there could be practical barriers against switching.</p> <p>The majority of the PPPs with the highest MPI are subject to the same overall tax regime. Their key features are diverse. The main characteristic of PPPs with a higher MPI is a certain level of flexibility.</p>	Ranking	Member State	coded name	1	Germany	Germany Riester	2	Spain	Spain IPP	3	Belgium	Belgium PP	4	Denmark	Denmark RP	5	Austria	Austria PZV	<p>3</p>
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<p>Practical implementation aspects</p>	<p>General methodology of phase 3 (interviews) and phase 4 (feasibility assessment)</p>	<p>The final part of this study on the feasibility of a European initiative for a pan-European personal pension product deals with the following aspects:</p> <ul style="list-style-type: none"> - Compare the successful features identified in the course of phase 2 with the stakeholders’ views (consumers, providers and regulators) gathered during a workshop held in Brussels on 15 February 2017; - Establish a PEPP ID Card covering a set of preferred features to be included in a possible PEPP framework; - Assessment of the PEPP ID Card in relation to the tax environment and; - Assessment of the market potential. 	<p>6</p>
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Results of supply and demand side discussions in the context of a workshop

The main purpose of the workshop was to exchange views and find consensus with a variety of stakeholders from supply and demand perspectives on the possible relevant features and overall architecture of the PEPP. The main results of the workshop can be summarised as follows:

Accumulation phase:

- In-payment characteristics:
 - o No mandatory minimum set at EU level but limits could be set at provider level
 - o Possibility of changing the level of in-payments during the accumulation phase
 - o State and employer subsidies allowed at (EU level)
 - o No maximum age limit for the start of the accumulation phase set at EU level
- Investment strategy:
 - o Multiple investment options and a default investment option should be offered to the consumer but these investment options should not be defined at EU level
 - o Changes in investment strategy should be limited and carefully advised
- Mitigation of risk:
 - o Need to ensure consumer protection and competitiveness with local products
 - o No full capital guarantee is needed
 - o No disability coverage
 - o Optional death coverage
- Early out-payments:
 - o Early out-payments should be allowed but limited

Decumulation phase: No harmonisation

Providers:

- The provision of PEPPs should be fully open to asset managers, insurers and banking institutions
- Current EU rules applicable to providers should be sufficient

Distributors:

- The distribution of PEPPs should be fully open to all types of distributor
- Online distribution should be allowed at EU level
- Online distribution without advice should be limited

Portability and switching:

- Switching should be allowed at EU level
- Switching should be subject to a mandatory minimum holding period
- Switching should be subject to a cost-based, capped charge

Advice and transparency:

- Current EU rules should be used as a basis
- Advice should be mandatory and free (payable only when specific)
- There is a need for an EU information document (set of information determined at EU level) as well as local information documents

<p>Results based on a technical assessment of the tax incentive regimes</p>	<p>Based on the clustering performed during phase 2 of our study, a comparison between the PEPP features requested during the workshop and the current PPP features and their related tax incentives in the accumulation phase, was performed.</p> <p>This analysis was performed on all features determined during phase 2. For comparison purposes, features relating to switching were discarded to assess the access of the PEPP to local tax incentives.</p> <p>Regarding switching possibilities, some PPP legislations currently do not allow the pension saver to change providers, or this operation triggers taxation. However, switching should be considered as an essential feature for the success of the PEPP.</p> <p>This analysis identified a possible need for the adaptation of the features relating to early out-payments. Early out-payments should either not be allowed, or allowed in limited situations in order for the PEPP to give access to tax incentives in certain Member States.</p> <p>After the adaptation of the above feature, the analysis of the different Member States' tax legislations shows that the PEPP should theoretically benefit from tax incentives in 9 Member States and would benefit from tax incentives in 14 additional Member States if only one feature is adapted (legislations where early out-payments are allowed without restriction and legislations where disability coverage is mandatory).</p> <p>Despite the high level of heterogeneity of PPP tax regimes across the EU, as highlighted by our study and based on the results of the workshop compared to EY findings, a PEPP with accumulation features harmonized at EU level in a flexible way and a decumulation phase left up to Member States should be an efficient solution to enable PEPP subscribers to benefit from local PPP tax incentives.</p>	
<p>Remarks</p>	<p>Our study did not deal with the following aspects, which will need to be discussed further in the course of the design of a PEPP framework:</p> <ul style="list-style-type: none"> - Authorisation regulations relating to providers and distributors of the PEPP, notably regarding portability aspects and the potential need for a provider to adapt some features to Member States' requirements; - Information and investment strategy correlated to a regulation applicable to given types of provider; - Switching regulations, notably in the context of different existing regulations on providers; <p>Additional issues emerged from the study findings and need to be assessed further in the course of the elaboration of a PEPP framework.</p>	

	<p>Market potential assessment</p>	<p>Our assessment suggests a market potential estimated at EUR 0.7 trillion for the 28 Member States.</p> <p>This estimate is within a range between EUR 0.4 and EUR 1 trillion.</p> <p>It assumes that the PEPP will replicate the market penetration of the most advanced PPP products in each Member State. It also assumes that the PEPP benefits from the same favorable tax incentives as those currently granted to other PPPs in each Member State.</p>	<p>5 and 6</p>
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