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PROPOSED DIRECTIVE REGULATING THE ACTIVITIES OF INSTITUTIONS FOR OCCUPATIONAL RETIREMENT PROVISION [COM(2000) 507 FINAL OF 11.10.2000]

UNICE POSITION PAPER

In October 2000, the Commission issued a proposal for a directive regulating the activities of institutions for occupational retirement provision (IORP) (COM(2000) 507). **UNICE wishes to highlight the importance of this proposed IORP directive.** It establishes a framework for the operation of occupational pension funds across the EU as a whole.

The Financial Services Action Plan proposes the creation of a single market for financial services by 2005, and a further target date of 2003 for securities market integration was introduced at the Stockholm summit. The IORP directive is an integral part of these reforms. Nevertheless, governments currently appear unwilling to drive the proposal through the decision-making process.

The IORP directive proposes the mutual recognition of occupational pension funds across all 15 member states. Currently, regulatory differences between member states inhibit the cross-border operation of pension funds in Europe. This means a single market for occupational pensions is far from being a reality.

The directive would enshrine the prudent man principle as the regulatory basis for investment choices, rather than regulating investment decisions through the imposition of quantitative restrictions. Work with our member federations has highlighted some misunderstanding of the prudent man principle; our concern is that such misunderstanding is impeding the progress of the directive.

The directive outlines the key features underlying the prudent man principle:

1. Take into account the nature and duration of the future pensions.
2. Ensure security, quality, liquidity, and profitability of the portfolio.
3. Assets are to be properly diversified.
4. Invest no more than 5% of technical provisions in sponsor.

Several conclusions can be drawn from these principles:

- The prudent man principle does not imply complete freedom for investment decisions. Rather it prescribes that investments should be adapted to the nature and duration of the liabilities of the fund, based on a precise and prudent evaluation of these. The appropriate degree of diversification of assets is chosen taking due account of the risks. Respect of the prudent man principle in investment decisions is a clearly verifiable condition, and it does not – as is sometimes suggested – entail subjective judgements.

- The diversification of assets implies investing in equities, as well as fixed-income securities, such as government bonds. Shares have proven to yield higher returns, but also to be less volatile, than government bonds in the longer term. Thus, diversification increases returns and security of investments. The prudent man principle allows for investments to be appropriately diversified.

The proposed directive includes not only prudency rules for investments, but also envisages supervisory rules and rules requiring technical assets to cover acquired pension rights.

The benefits of this directive extend further than might first appear – they go well beyond the internal activities of pension funds. UNICE describes this as a win-win-win directive. The improvement in the yields earned by occupational pensions funds would benefit employees, employers, as well as the macro-economy as a whole.

- Employees would benefit from higher retirement benefits; the introduction of a framework for occupational pensions, and the funded schemes this would encourage, could also help to maintain the overall level of retirement benefits. There should also be a considerable increase in competition in the provision of pensions, improving the package offered to the users.

- Where funded schemes have been established – and have matured – employers have benefited from lower pension contributions, and consequently contained their labour costs. The IORP directive would make it easier for more member states to introduce funded systems, while also improving the performance of funded schemes. This directive would provide further savings for companies by allowing them to organise the pension arrangements for all their employees within a single pension fund. Improved capital market integration will also lead to more active venture capital activity, which will particularly help SMEs. Similarly, many companies would benefit from lower capital costs, as their access to cheaper financing in equity markets increased.

- The macro-economic benefits from the genuine cross-border operation of pension funds would be considerable. Pension funds represent a very large share of capital markets in Europe, notably accounting for a significant share of venture capital. Removing barriers to their investment activities across the Union would represent a substantial step towards a single market for capital in Europe. Improved earnings on such a large amount of assets can only benefit the wider economy. Furthermore, effective second pillar schemes could relieve some of the pressure that public pension schemes will put on state finances in future years, so improving the stability of public finances.

In this way, it should be possible to alleviate the pressure from the population time-bomb, by developing effective second pillar pension schemes. The funds destined to occupational pension funds are expected to increase dramatically in coming decades. The directive would establish an appropriate framework, allowing these funds to be used in the way desired by the contributor.

Finally, UNICE wishes to remind all participants that this directive seeks to improve the functioning of the capital markets, and, as such, it should be wholly treated as a financial services measure.

The European Parliament made several amendments to the directive in July 2001; overall these markedly improved upon the original proposal.

The European Parliament's amendments

UNICE is broadly welcomes the European Parliament's amendments to the proposed directive.

The European Parliament has clearly recognised that liberalisation of pension fund activities is the appropriate path to follow. The explicit inclusion of the "prudent man principle" as the basic principle for pension fund management represents is an important step towards raising the investment performance of funds. The elimination of quantitative restrictions on investment decisions (over a five year transition period) is similarly welcome.

The European Parliament was also wise to ease the funding requirements in the proposal; the original stipulation that assets cover liabilities "at all times" would have led to inefficient over-funding, and hence lower returns for investors. The amendment that this funding requirement be met on average over a period of one year avoids such difficulties.

UNICE's main reservations concern the restrictions that have been imposed upon pension funds in terms of the products they provide. The proposal includes a compulsory bio-metric risk option, a compulsory option for guaranteed redemption of contributions, and governance requirements. These restrictions upon pension fund activity risk deviating the directive from its intended purpose, as well as burdening businesses with additional administrative costs. The single market for capital, and the smooth development of occupational pension schemes must be the priority for this proposed directive. Imposing ulterior objectives – however desirable – upon the proposal may reduce its quality and its impact.

Currently the proposal remains before the Council. Progress under the Belgian presidency was very disappointing. **The size of the potential gains makes it all the more incomprehensible that there should be such limited progress in the Council.**

UNICE has higher hopes and expectations for the Spanish presidency. Greater financial market integration has been highlighted as a priority for the Spanish presidency. It is correctly recognised that implementation of the Financial Services Action Plan is needed for this. The IORP directive is an essential element within the FSAP – its omission would be a grave mistake. **UNICE urges the rapid adoption of the proposed IORP directive**, including the liberalisation of investment rules as proposed by the European Parliament (taking into account our comments made above).

It should be pointed out that a fully integrated market for occupational pensions requires an appropriate tax treatment. Currently there are differences between member states, which can result in double-taxation – or zero-taxation. These discrepancies arise due to taxes being levied at different stages of the process – on the contribution, the pension fund investment, or the final payout. These differences will continue to represent a significant impediment to the cross-border mobility of labour in Europe. Serious consideration should be given to these issues upon the implementation of the IORP directive.

While this position paper focuses upon second pillar pension provision and financial market aspects, UNICE also produced a broader strategy paper on the sustainability of pensions in November 2001.

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