New Finance Watch Report:
"A Pot of Gold at the End of the Rainbow The future of pensions in the EU"
(June 2017)

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Executive summary

1
In many EU countries, public Pillar 1 retirement systems are creaking under the strain of a triple challenge:

1. a demographic shift, marked by a smaller, rapidly ageing population,
2. slow economic growth, and
3. increasing inequality of income and wealth.

2
A large section of the formal labour market could be at risk from the advances in automation and digitisation at the workplace.

Fewer jobs, shorter tenures and more fragmented employment histories imply that Pillar 2 pensions, too, could become less reliable sources of old-age income.

3
Recent reforms of Pillar 1 pension systems in EU member states have concentrated on reducing immediate budgetary pressures,

... mainly by increasing the pensionable age and by closing off early retirement options. In the absence of additional measures, future pensioners are facing the risk of substantially reduced replacement rates. Old-age poverty could be a real concern.

4
We endorse, in principle, the concept of including more capital-funded pension models in the framework of Pillars 1 and 2,

... in order to reduce the dependency on inter-generational transfers. We recognise, however, that the introduction of capital-funded, defined-contribution (DC) pension plans takes time and places an additional burden on particular age cohorts, which are called upon to support the existing pay-as-you-go (PAYG) system while pre-funding the capital stock of the new regime.

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5

Promoting Pillar 3 pensions could be helpful in reducing the pension gap.

Given their relatively small overall contribution to the overall pensions pot so far and the fact that Pillar 3 pensions tend to absorb savings from other channels, it is uncertain, however whether the potential contribution of Pillar 3 to closing the gap will be substantial.

6

Given the scale of the challenges facing pension systems, and social security systems in general, across Europe we would encourage policy makers:

- to also look beyond incremental improvements to the existing frameworks and explore the feasibility of alternative models,
- to build a future-proof foundation for the European model of the Welfare State and empower European citizens to embrace, and thrive on, the potential of technological innovation.

We also take the opportunity to share some observations on the Commission's plans for a Pan-European Personal Pension (PEPP) product. Finance Watch welcomes the initiative and proposes a number of criteria that should distinguish the PEPP from other savings products and make it an attractive and safe option for European savers.

7

The proposed product should be a genuine retirement product,

... providing, at a minimum, vesting at the statutory retirement age, longevity risk-sharing and an emphasis on income-generation and sustainable investment.

8

The proposed product should be simple, safe and transparent,

... with a default option that provides safety, in the form of a capital guarantee, cost effectiveness, by means of a cap on fees and charges and competitive performance, supported by switching and portability features.

9

The proposed PEPP product should be designed to allow for a maximum of cross-border portability.

At present, cross-border provision accounts for only a small fraction of the personal pensions market in the EU. As a dedicated "second regime", PEPP would be perfectly suited to specifically address and promote this market segment.

10

We recognise that EU legislators have no competencies in the area of taxation,

... which is seen by many as the single largest obstacle towards the establishment of a single European capital market, in general, and of a successful PEPP product, in particular. Finance Watch would strongly encourage the EU to address this issue, e.g. by developing a mechanism for calculating and collecting balancing payments among member states.

Finance Watch's recommendations for a Pan-European Personal Pension Product (PEPP)

In order to strike a balance between safety and performance, but with a particular emphasis on the stated aim of the PEPP to cater specifically to financially less literate citizens, the design of a PEPP product would, in our view, have to conform to the following minimum standards:

Simple

A PEPP product must be designed specifically as a pension product and have the explicit objective of providing an income after retirement: the start of the decumulation phase must be referenced to a (statutory) retirement age and the early withdrawal of capital during the accumulation phase limited or penalised.

The PEPP product must contain a limited number of options, including a default option, which provides for a low risk, low-cost annuity with a capital guarantee and a cap on costs and charges.

A PEPP product must be available through a variety of distribution channels, including non-advised sales via the internet. All distribution channels must provide access to the same core documents and follow the same simple, pre-defined decision tree.

As a general rule, a PEPP product may only provide investment exposure to "non-complex financial instruments" in accordance with Article 30/3.a.i. of the Insurance Distribution Directive (IDD) .

> "Most pension savers are disengaged from the pension saving process, do not understand the risks that they face, and are generally not skilled enough to exercise their sovereign rights as consumers."
>
> **UK Independent Review of Retirement Income, March 2016**

Safe

The default option is designed to produce a stable and predictable lifelong retirement income, by way of a lifetime annuity. Exceptions from annuitisation (i.e. draw-down of a lump sum) apply only where the size of the accumulated pension pot is not sufficient to generate a meaningful annuity income.

The default option contains a guarantee on the accumulated capital. PEPP providers must be authorised under one of the relevant regulatory regimes (e.g. Solvency II IORP II) and comply with prudential minimum standards, in particular regarding the provision of capital guarantees.

A PEPP product must provide the option for the customer to switch providers without incurring charges, subject to statutory minimum holding and/or notice periods.

At the end of the accumulation period, i.e. upon reaching the retirement age, the customer must be free to obtain competitive annuity offers from different providers ("open market option").

PEPP contracts purchased through non-advised distribution channels, e.g. online, must be subject, at a minimum, to existing EU consumer protection rules, e.g. under the Distance Marketing and E-Commerce directives.

Transparent

A PEPP product must be based on a default option, with a limited number of alternatives. Providers and advisers are obliged to apply a simple, pre-defined decision tree with a limited set of default pathways and subject to appropriateness tests.

The principal features of a PEPP product must be set out in a clear and concise way in a fact-sheet, based largely on the key information document (KID) for Packaged Retail and Insurance-based Investment Products (PRIIPs) .

Value-for-money, e.g. of annuity products, must be disclosed in a simple, readily comparable manner using uniform, standardised metrics defined by regulation.

For the default option, at a minimum, a PEPP product must provide for a cap on costs and charges.