SCHEME DESIGN

Seas of possibilities

Sunniva Kolostyak explores the elements of cross-border pension funds and the challenges that need to be overcome to create better solutions across European state borders

WRITTEN BY SUNNIVA KOLOSTYAK

A pension fund with horizons stretching across several states, businesses and industries, able to provide returns of scale while still fulfilling reporting requirements. This would have been a dream just a few years ago, but the concept of a cross-border pension industry has anchored. Could this be something that will unite Europe, or is it another wedge in an already polarised environment?

There is no standalone definition of what a cross-border scheme is, but what they have in common is that they are all Institutions for Occupational Retirement Provision (IORPs), established in an European Union (EU) or European Economic Area (EEA) state, and are able to house members of different citizenships.

Establishment

From December 2005, pension schemes located in an EU state could apply for authorisation to include contribution-paying members who are subject to another EU state's social and labour law. This included the EEA states Norway, Iceland and Liechtenstein from 2007. The design allows members to be part of a scheme that facilitates movement of workers throughout the EU, according to law firm Sackers.

Setting up a cross-border solution is something that can take over a year, according to State Street Global Advisors (SSGA), but the centralised approach to administration makes these options a great alternative and increases multinational companies' understanding of factors that impact member outcomes, which includes governance, investment defaults, member education and financial wellness, transparency and value for money.

Companies have two options when adopting pan-European pension funds: Single-employer and multiple-employer vehicles. SSGA senior pension strategist, Jacqueline Lommen, mentions that there are between 70 and 80 of these funds in Europe, 25 of which are 'real and tangible'.

"What you see is that this number is growing, steadily and slowly, but that is fine," Lommen says. The big ones, she continues, are owned by big multinationals such as Johnson & Johnson, Pfizer, Nestle and GE. In addition, cross-border funds set up by financial providers, the master trusts, have also become popular over the past few years.

"It gives them more control and grip on pension liabilities and costs – it provides opportunities for streamlining of local pension arrangements, for buying power, they become bigger and you have the advantages of scales," she adds.

Benefits

The benefits of going international with pension funds have rallied several people to its side in support, and even spurred new organisations such as the Cross Border Benefits Alliance-Europe (CBBA-Europe). CBBA-Europe secretary general, Francesco Briganti, says a good pan-European solution can centralise governance, reduce costs and become more efficient than a local fund. Most importantly it can provide higher pensions because of the big pots and low costs.

For workers who move between countries throughout their careers, one of the key benefits is overcoming the fragmentation of different social systems.

Briganti explains that the fragmentation is a challenge as the workers are unable to take their acquired pot with them across state borders, even if they work for the same company in another country.

"You can imagine that it is incredibly costly for workers because every time they move to another country they have to set up a new pension plan in their new country of residence and at the end of their careers they will have several pension plans, and many of them will be dormant for years and years," he says.

Amundi Global head of retirement solutions Christian Lemaire, who regularly works with clients to set up cross-border funds, says there are a number of other challenges, including keeping up with regulations across several countries, but that cross-border pensions is a growing market.

"It seems more and more complex to be able to manage that alone in several countries. Now that you have more and more regulation, more and more constraints, it's more and more expensive to run a pension fund," he says.

However, through centralising funds' capital and governance, it is easier to ensure economies of scale, Lemaire explains.

"Some member states have a strong will to protect their own market so it means that it will take time, but we believe that the market, as well as with the Pan-European Pension Product (PEPP) project, will increase this market in years to come."

Lommen says there are several driving forces behind cross-border solutions who each expand the process of setting up a fund in steps and that it always comes back to the stakeholder management.

Shareholders

Lommen, who has been closely involved in establishing and running the first large cross-border pension funds for multinational companies in Europe, explains that there usually are four different stakeholders involved.

At the top there are the international and corporate drivers, often the chief risk and financial officers, and the HRM departments, who all are interested in making cross-border solutions work.

"It gives them more control and grip on pension liabilities and costs, it provides opportunities for streamlining of local pension arrangements, buying power, it becomes bigger and it has the advantages of scale. You have single reporting instead of reporting in each country. So there are a lot of very tangible drivers," Lommen notes.

On the other end you find the trustees and officers of local pension schemes, she continues. "They think 'hey, what is this, why should I cooperate, what's in it for me'? And that is the downside."

Challenges

According to Briganti, the reason why stakeholders are struggling to create solutions is protectionism. He agrees with Lommen that there is strong opposition from local small and medium pension providers who are afraid of competition from other countries. These funds know the internal market, he says, and most importantly they have the trust of local clients and supervisors.

There is also opposition from unions in many countries, both trade unions and employer associations, opposition that can be huge in some sectors. "Unions in many countries participate in the governing of pension funds and in some countries they even represent as much as 50 per cent of the administrators, and you can imagine that sitting at the board of a pension fund implies power, implies bargaining power."

Fear of losing this power can be a great motivator for working against pan-European solutions, which also applies to states and governments. States are ruled by two fears – fear of lost tax revenue and the loss of political control over the capital.

"They are afraid that somehow they will not receive the same tax income with the cross-border solutions." Meanwhile, the misconception that capital going abroad is common. "If money is at home they can control it better," Briganti says.

Lommen says locally, supervisors, regulators and politicians often are negative to European and EU initiatives. "They do not always like international involvement or international influence. So they are reluctant to support these kinds of developments in the member states," she notes. But, if the taxation formula is harmonised across states, this revenue will not be lost.

"I don't think countries should be worried about the level of taxation, no one is trying to harmonise the level of taxation. The point is to harmonise the taxation formula, when you get this money," Briganti says, pointing out that it could get messy and complicated if you mix EET and TEE regulation.

"You can ask different amounts. If country A decides to have 15 per cent taxation on the benefits and country C decides to only have 5 per cent taxation on the benefits, I do not think that would represent an obstacle to cross-border pensions.

"I am saying that this fear from some countries of losing tax income because of cross-border or pan-European solutions doesn't make sense," Briganti affirms.

As more research, providers and offers are emerging, pan-European pension funds have become a practical reality, and not just a dream that can never be realised, according to State Street. With the enormous potential, it seems like a viable option for future savers if countries could unite. ■