



CROSS-BORDER SCHEMES

Beyond borders

Natalie Tuck looks at the current situation with cross-border pension schemes and what the future holds

WRITTEN BY NATALIE TUCK

Freedom of movement, be it capital or people, is one of the fundamental principles of the European Union (EU). Citizens of any member state are also citizens of Europe, free to live and work in another EU country of their choice. It makes sense then, that workers' pension schemes should also have that freedom.

Cross-border pension schemes are not new; legislation was made to facilitate such schemes in the first Institutions for Occupational Retirement Provision (IORP) Directive in 2003. The European Commission updated the regulations with the IORP II Directive, which was adopted in 2016 (some countries are yet to transpose the legislation into domestic law).

State Street Global Advisors senior pensions strategist, Jacqueline Lommen, says there are around 80 occupational cross-border IORPs but many are small schemes operating between Ireland and Northern Ireland with examples of just two or three members in some schemes.

"There are around 35 large schemes, and 20 of those are in Belgium," she says. "That's a beautiful world and I think the storyline should be that there is a new market out there. Although you don't necessarily hear them, they don't speak up, but if you look at the data and the figures, then you can see that there has been steady growth."

As set out by the first IORP Directive, Cross-Border Benefits

Alliance-Europe (CBBA-Europe) secretary general, Francesco Briganti, explains that companies have to comply with the national social and labour laws, and with the national taxation rules of the states where they offer occupational pensions.

"As an example, if the cross-border pension fund is based in country A (home state), and operates in countries B, C and D (host states), it is necessary to create specific national compartments complying with the national social, labour and taxation laws of countries B, C and D. In principle, the applicable legislation on capital requirements, investments, governance and information will instead be in country A," he says. However, he notes that sometimes cross-border schemes must comply with local rules on investments too.

Types of cross-border schemes

Some employers have chosen to set up their own in-house cross-border IORP, whereas others opt to join a cross-border master trust. In this rapidly increasing defined contribution (DC) world, one might think that most of the schemes are

DC, but that's not the reality. Aon partner, Thierry Verkest, says: "We tend to talk about cross-border schemes as a whole, but we should also look at DC cross border and defined benefit (DB) cross border because there is quite a difference.

"Initially many consultants said that cross border would only be applicable for DC plans as they thought at the time they were talking about Ireland and the preferred arrangement would be DC. But what happened in reality is that companies set up their European funds as DB, and most of the cross-border plans are DB. It is only in the last couple of years that companies are beginning to include DC schemes in their existing pan-European structures."

Whatever type of scheme, Briganti says that cross-border IORPs are easier to set up now than in the past: "Expertise, experience, clarification and good practices have been developed over the past 18 years."

Current issues

Although the cross-border schemes set up have been successful, many experts agree that the sector hasn't grown as much as they would have hoped. Briganti says the reason why there are so few cross-border IORPs in Europe is due to "fear and scepticism from companies that still think such operations are more complicated and costly than they really are".

Verkest adds that it is generally considered as an "ideal concept" but "some people don't like to have their pension plans based in another country other than their own country". He agrees that emotions and lack of trust are some of the biggest barriers to creating a cross-border scheme. "Communication is therefore key. It is important to show the win/win for both employer and employees," he adds.

In addition, the long-awaited IORP

II Directive has led to disappointment from many who work in the sector. Amundi global head of retirement solutions, Christian Lemaire, notes that the transposition of IORP II by member states should have been completed by 13 January 2019.

However this hasn't been the case, and last year the European Commission launched infringement proceedings against 17 member states.

"In addition, in their transposition, several member states have added new local specific requirements, which make it quite difficult to transfer a local plan into a cross-border IORP," he adds. One of those countries is the Netherlands, which has implemented a rule that means schemes wishing to transfer to another country require the approval of two-thirds of their members.

Verkest believes it is a "political decision" as quite a few DB and DC pension schemes in the Netherlands had moved to Belgium and are all working well. "Since they have introduced that rule no pension scheme has transferred to Belgium, so they have achieved their objective. It goes right against the freedom of movement and capital in Europe."

As a result of this, in December 2019 Aon's United Pensions stopped offering its services as a solution to Dutch clients.

Another issue that affects DB cross-border IORPs is the requirement for those schemes wishing to transfer to be fully funded. It is something that has existed since IORP I but Verkest believes it is a "discrimination between local and cross-border plans".

"For DB plans, the EU should walk away from that fully funded principle because it makes no sense, especially because at a local level you do not necessarily have that fully funded principle, and suddenly on a cross-border level you need to

be fully funded at all times." Doing so, he says, would facilitate the cross-border transfer of poorly funded plans.

Delegation: A rising trend

Outsourcing has become very popular within the pensions sector and cross-border schemes are no exception. Verkest says that over the years he has seen a move to outsourcing. "It starts with member administration, payroll, and actuarial work and then investments. Now companies are looking at delegating the governance to multi-employer solutions," he says.

"That is quite a new trend and when we talk to companies you see the focus on the core business, why would a multi-national company invest in pensions people when they can move their pension plan to experts? That is also the reason why we set up United Pensions as we expect more companies to think like this."

Verkest says Aon has been offering cross-border pension solutions since the introduction of IORP I. Since then they have set up around 10 schemes, all of which remain open today, with a mix of DB and DC. Employers can set up separate sections for their own schemes within United Pensions, which Verkest calls a "fund in fund principle".

Another option for employers is Amundi's cross-border IORP available for DC schemes. Lemaire explains: "This IORP is structured in country compartments to be compliant with the local social and labour laws and taxes....as these regulations are very specific with no European harmonisation planned in the year to come, we focus on a multi-local approach with our main subsidiaries and dedicated investment retirement solutions, such as customised

Design

life-cycle strategies, which includes the decumulation phase.”

These two providers currently do not have that many competitors. At a recent conference hosted by CBBA-Europe, several speakers encouraged more providers to enter the market. Owens Corning compensation and benefits manager, Sjuck de Bordes, said at the time that if others enter the market “it will be a good thing”.

Lommen believes the rise in cross-border-multi-employer schemes is the “tipping point” that the cross-border IORP sector needs. She explains that they “make life easy for multi-national plan sponsors, especially those that have smaller groups of employees within different countries”.

“I also think that if there are more supplier solutions then there will be more employers looking into cross-border pension schemes,” she adds.

PEPP talk

The European pensions industry has been talking about a pan-European personal pension product (PEPP) for several years. Industry body, the European Insurance and Occupational Pensions Authority (EIOPA), made groundwork last year, setting up an expert panel and publishing a public consultation on the subject.

The PEPP is being designed as a third-pillar pension product, but could employers use it instead of a cross-border IORP? According to Briganti, several large employers have already asked him if they will be able to offer a PEPP to their employees.

“That means there is an interest, at least for some, for these new European pension products. I think that if the PEPP is well designed and reasonably cheap, some companies will try to replace workplace pensions with PEPPs. Having said that, considering that the PEPP is an individual pension product, companies could only pay

contributions to a PEPP provider on behalf of their workers, or they could offer an additional cash benefit to their employees in order to allow them to buy such products,” he says. However, he points out that for the latter option, companies would not have the legal power to oblige their employees to use this money for a PEPP.

Verkest believes that the PEPP concept would be attractive to occupational pensions because it would mean that the employer can pay a contribution for the employee, who could invest it with a provider of their choice, meaning that the employer has no liability.

He also thinks it would appeal to member states as a PEPP could operate on a tax-exempt-exempt (TEE) principle. “That means the tax goes to the country where you work and live, and there is no tax at the end on the benefit,” explains Verkest. “The member states would welcome the principle because they would receive the tax today, so I don’t think anyone would be against that, and it would solve lots of issues of double taxation treaties.”

Regarding the PEPP, Lommen adds that when you talk about it, it sounds controversial, but she could

see it being offered as an occupational pension, like a group contract seen in the UK with group personal pensions.

“The contract sits with the individual and as an individual you buy and conclude the contract, but it is being distributed through worksite marketing or through the employer in a group contract. A group contract would deliver economies of scale and cost efficiency. I think it’s the way forward, so formally it’s still third-pillar, but its impact on the market is that it is a collective group solution. I think it makes sense.”

All that being said, EIOPA hasn’t completely given up on designing its own cross-border DC IORP. At the CBBA-Europe Annual Conference in November 2019, its executive director, Fausto Parente, said the association could revisit it if there is demand. Briganti believes the creation of a new EU legal framework for Occupational DC pensions, a pan-European occupational pension product (PEOP), could accompany a PEPP. “If a PEOP is created by the EU, then the aforementioned risks that PEPPs will be offered by employers will be prevented.

“PEPPs will remain personal pension products, while the PEOPs will become the occupational ones.” Europe is a long way off having a fully integrated pension system and with such heterogeneous systems, it’s hard to ever imagine it will. But those cross-border IORPs in existence are a sure sign that complexities around governance, administration, tax and communications can be overcome.

As Verkest states about cross-border schemes: “Each single cross-border activity that has been put in place is still operational. I’ve not seen one single scheme be wound up. It’s all running, and running well, and it shows that it works.” ■

