Association européenne des institutions de retraite du secteur public (AEIRSP)

Europäischer Verband der Versorgungseinrichtungen des Öffentlichen Dienstes (EVVÖD)

European Association of public sector pension institutions (EAPSPI)
Régie par la loi du 1er juillet 1901 - déclarée à la préfecture de la Gironde – Bordeaux – France - n° 2/225493

Proposal for a directive on improving the portability of supplementary pension rights

- Position Paper -

A. Introductory remarks

The European Association of public sector pension institutions (EAPSPI) is in favour of any measures – at European and national levels; undertaken by governments and social partners – which help to promote portability of supplementary pension rights. Portability is considered as very important for the social protection of workers in view of the general decline in first pillar pension provision in many European countries.

However, there are doubts as to whether this Proposal is too ambitious, as far as aspects beyond the scope of portability alone are concerned. In view of the principle of subsidiarity this affects in particular the shortening of vesting periods and the adjustment of preserved rights. Another critical point is that the proposal sets out no obligation on accepting a CETV. Finally, although being tackled in the Commission staff working document on several occasions, the problems linked to the different systems of taxations are not mentioned in this Proposal, even if the Commission had already identified the tax barriers as one of the most important obstacles to the free movement of workers within the EU.

The following paper attempts to show the possible impacts of this Proposal on the public sector supplementary pension schemes. In this context, one should bear in mind that the adoption

of this Proposal requires unanimity within the Council, as its basis in law is Article 42 and 94 of the EU-Treaty.[1]

This analysis is based in the main on the English text of this Proposal (including its explanatory remarks) as well as on an extensive working document from the staff of the Commission,[2] giving detailed information about the considerations of the Commission. One should also note that there are differences in translation into national languages.

With this in mind, EAPSPI's comments on this Proposal are as follows:

B. Analysis

1. Article 1 – Objective

In the explanatory memorandum, the Commission mentions that the proposal is designed to simultaneously reduce the obstacles both to freedom of movement across Member States and to mobility within a Member State stemming from provisions contained in these supplementary pension schemes. In Article 1, only "the right to occupational mobility within the same Member State" is mentioned. It might be supposed that the wording "the right of workers to freedom of movement" is aimed at the issue of mobility between Member States, nevertheless it should be stressed that this aim also needs to be set out clearly in the directive itself.

[1] P. 3 of this Proposal – Explanatory memorandum, n° 3 (legal elements of the Proposal)
[2] SEC (2005) 1293 of 20th October 2005

2. Article 2 – Scope

The "target problem" of the directive is also highlighted by the reference to regulation (EEC) Nr. 1408/71 in Article 2 of this Proposal. Regulation 1408/71 of itself requires there to be a cross border transfer between at least two Member States. Thus, this regulation is not applicable in an ordinary national case. Once again, the general target of the directive seems unclear and it seems to contradict Article 1.

3. Article 3 – Definitions

According to Article 3 lit. g), portability is defined as the *"option open to workers of acquiring and retaining pension rights when exercising their right to freedom of movement or occupational mobility."*

The question to be discussed is whether **this definition corresponds to the original notion of portability. With its root in** Latin word "*portatio"* (meaning "transport"), the English expression "*portability"*[3] only covers the transfer of pension rights linked to a job change. Thus, the initial meaning of the word „portability" does not cover the enlargement of the notion „portability" to the conditions of acquiring and retaining pension rights. In this context, the initial definition of the European Commission in its questionnaire for preparing this draft, addressed to the Member States and other stakeholders, was restricted to the mere transfer of capital representing the pension rights to be transferred.[4] Thus, this definition contains a new and discreet interpretation of this notion.

[3] As well as the French expression "*portabilité*" and the German wording "*Übertragbarkeit*"
[4] Cp. Commission staff working document, p. 62

The Commission is not coherent in their own argumentation. In the Communication dated April, the 19th 2001 (COM(2001) 214) entitled, „The elimination of tax obstacles to the cross-border provision of occupational pensions“, the Commission mentions in point 3.6, pages 13 and 14, that there are obstacles with regards to taxation when considering cross-border transferability of capital. In this context, the definition of "transferability" and "portability" are used in their well-known common sense.

Article 3 lit. j) defines “transfer” as the “*payment …. of a capital sum representing all or part of the pension rights acquired under the scheme ….”*. This definition seems to be in contrast to Article 6 (1) where the outgoing worker may obtain the transfer of only all his acquired pension rights. **A partial transfer of acquired rights might be contradictory to the intention of portability, which** is to bring together different pension rights within just one pension institution. Furthermore, the possibility of permitting a partial transfer could generate very small pension claims, leading then to high internal costs falling to the supplementary pension schemes.

Furthermore, Article 3 lit j) apparently allows a transfer not only between the schemes of the 2nd pillar, but as well from the 2nd to the 3rd pillar (“…… *of transferring this sum to a new supplementary pension scheme* [= 2nd pillar] *or another financial institution* [=3rd pillar]….”). In order to avoid any confusion about the notion of financial institution, it should be defined in Article 3; otherwise it would be better to refer simply to an “Institution providing pension rights”. The further question to be answered is whether such a “cross-transfer” meets the interest of all occupational pension schemes, which provide pension rights.

4. Article 4 – Conditions governing acquisition

Besides Articles 5 and 6, **Article 4 is the core of this Proposal**. Article 4 contains measures to improve the conditions governing acquisition.

As already mentioned above[5], it is perhaps questionable whether any measures for improving the acquisition of supplementary pension rights are still covered by the notion of "portability". Furthermore, it is doubtful whether such a rule is in line with the **principle of subsidiarity, enshrined in Article 5 of the EU-Treaty.**

According to Article 5 EU-Treaty, the Community shall take action in areas which do not fall within its exclusive competence, "*in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community."* This principle of subsidiarity, formulated in a quite abstract way, has subsequently been strengthened by the Protocol n° 30 from 2nd October 1997[6], set up in the context of the Treaty of Amsterdam. The Commission, has also committed itself to the principle of subsidiarity in its work programme for 2006 that "*the EU should only act when necessary and in the lightest form consistent with achieving its objectives. The Commission will pay particular attention to ensuring full respect for subsidiarity and proportionality*."[7]

a) According to n° 2 of this Protocol, the principle of subsidiarity is used in consideration of the general regulations and the goals of the treaty. In particular, the principles for the **relationship** between the **community law and the national laws**, set up by the European Court of Justice (EJC), **are not affected**.
Supplementary pension rights are ruled by the EU-Treaty[8] and by other directives.[9] However these regulations only regulate the quite narrow question of equal treatment between men and women. The conditions governing acquisition, as set up in Article 4 of this Proposal, fall within the sphere of compe-

[5] Definition of "portability" under Article 3 lit. g)
[6] see annex III of the EU-Treaty
[7] Communication from the European Commission: „Unlocking Europe's full potential – Commission legislative and work programme 2006", COM (2005) 531 final of 25.10.2005, S. 10 (n° 6 "Delivery and better regulation – subsidiarity and proportionality")
[8] Article 141
[9] For example the directive 86/378/EEC of 24.07.1986

tence of the Member States.[10] This principle has even been enshrined in Art. 137 (4), first recital of the EU-Treaty. Even the **European Commission** has recently **recognised** this principle in the context of the **IORP-Directive**. According to recital 9 of the considerations, Member States should be responsible **for the organisation of their own old age pension schemes under the principal of subsidiarity**. Furthermore, this principle is enshrined it Art. 137 (4) 1st recital of the EU-Treaty, according to which the Member States retain competence for the organisation of their social security systems in context with the cooperation on EU-level.

b) According to n° 5, first recital of this Protocol, the principle of subsidiarity requires *"**cross-border aspects, which cannot be sufficiently regulated by measures of the Member States."*** With regards to the intention of this proposal, as formulated in the title *"directive ….. on improving the portability"*, it seems to be understood that any question of cross-boarder portability can be better determined by the Community if agreements between the single Member States or the European social partners will not achieve this goal.[11] However, **conditions governing acquisition do not contain any cross-border aspects** as required in these Minutes. In fact, conditions governing acquisition must be ruled by the national legislator or by the competent social partners, since supplementary pension schemes are – based on their initial meaning – always complementary to the first pillar of the respective Member States. Since the pension systems and the social targets are quite different in each Member State and the role, as well as the importance, of the second pillar varies from one State to the other,[12] respect for the principle of subsidiarity is even more important in the field of pensions. Therefore, the conditions governing acquisition of

[10] See ECJ: *Iurlaro vs. INPS* (C-322/95), n° 23
[11] See in this context the efforts undertaken before, Commission staff working document, p. 20/21
[12] There is, for example, a very "strong" second pillar in the Netherlands or in Great Britain in contrast to other continental western and southern European countries where the first pillar has (still) got a very important position

supplementary pension rights must be ruled by the national legislator or by the social partners in order to maintain the balance of the supplementary schemes with the first pillar.

c) According to n° 7 of this Protocol, ***"proven national regulations as well as structure and function mode of the juridical systems of the Member States"*** **are to be respected.** In the context of this Proposal, the **Commission** has stated, that the directive should **not discourage the future development** of supplementary pension provisions in the EU.[13]

As mentioned above, it is doubtful whether the conditions which govern acquisition, set up in Article 4 will respect proven national regulations as well as structure and functionality of the existing supplementary pension schemes. Each supplementary pension scheme is based on several parameters like – for instance – vesting periods or minimum entry age. If these parameters are to be (sensibly) modified, then the basic structure and the assumptions of the whole scheme have to be at least revisitied.

d) According to n° 9, third recital of this Protocol, the Commission should consider that the **financial load** of Member States and local authorities is minimised **and is appropriate to the objectives**. The measures in Article 4 of this Proposal, especially the maximum vesting period of 2 years, might considerably increase the costs of supplementary pension schemes in some Member States, as the Commission has already admitted.[14] Depending on the country and the nature of the insured persons within the relevant scheme, supplementary costs of between 5 % and 20 % might arise, simply from shortening the

[13] Commission staff working document, p. 26
[14] Commission staff working document p. 36

vesting period,[15] which in turn might impact on labour costs if the employer has to provide for the supplementary pension schemes under consideration.

Besides these concerns over the principle of subsidiarity, the following questions might arise out of the actual text of Article 4.

- Art. 4, lit a) envisages that all contributions in respect of unestablished pension rights should be reimbursed to the worker who is leaving. Since the ECJ has held that any benefits from occupational pension schemes form part of remuneration, it does not seem clear whether only the worker's own contributions or the employer's contributions as well are covered by this provision.

- From an actuarial viewpoint , it would be preferable that the cash equivalent transfer value (CETV), and not the contributions, should be paid over, since only the CETV takes into account that a part of the contributions is needed to cover the so-called "risk-elements", which in normal circumstances should not be reimbursed. Additionally, reimbursement seems to be risky with regard to young people. At the beginning of the professional career, on average there is not a lot of spare cash. Therefore, to match the challenges faced at job-change, the offer of additional cash is in the main welcome, for example, in order to finance new housing or consumption. It is therefore not unrealistic to suggest, that young people would in the first instance prefer refund of contributions to a transfer of their rights by means of their CETV. Such behaviour, however, would be contradictory to the concept of building up over time a right to a pension. Refunds therefore do not seem to be a desirable option. Any use of refunds always runs counter to the CETV concept.

[15] Attachment to EFRP position paper, imprinted in the German magazine *BetrAV* 2005, p. 679

- Furthermore, it is not clear whether refunds should be paid with interest or whether also surviving dependants (there is no hint of this in the text of the Directive) of the worker might claim the reimbursement.

- Article 4 lit b) fixes the minimum entry age as 21 years. Since the waiting period should not be more than 2 years, any national rules which stipulate a higher age than 23 years as minimum age for establishing any entitlement to supplementary pension rights will have to be revised. Additionally, it should be mentioned that the reference between Article 4 lit b) and Article 4 lit d) is not clear. Are they to be seen as cumulative or alternative?

- According to article 4 lit c), the worker can join the scheme after one year of employment. This delay has been chosen in order to be in line with the qualifying period, which generally does not exceed one year.[16] However, this will mean that workers with a temporary contract lasting more than one year will also have the right to join a pension scheme. This might be seen as running counter to the intention of the respective national legislator.

- It has to be mentioned, that the German, English, Italian and French version seems to be different in the wording.

5. Article 5 – Preservation of dormant pension rights

This Article foresees that *"Member States shall adopt the measures they deem necessary in order to ensure a fair adjustment of dormant pension rights so as to avoid that outgoing workers are penalised."*

[16] Explanatory remarks of the Proposal, p. 7

The Commission has proposed several possibilities how this "fair adjustment" can be achieved. According to recital 7 of the considerations, a "fair adjustment" can be achieved by indexing preserved rights against inflation, wage levels of pension contributions, which are in payment , or the rate of return on assets within the supplementary pension scheme fund.

Article 5 (2) contains an alternative to the fair adjustment that supplementary pension schemes can *"use a transfer or payment of capital sum … when these do not exceed a [certain] threshold."* This exception has been adopted to avoid excessive administrative costs stemming from the management of a high number of low-value preserved rights.[17]

Similar to Article 4, it does not seem clear whether this rule meets **the principle of subsidiarity**, set up in Article 5 of the EU-Treaty. Any indexation of preserved pension rights will **generate considerable higher costs** in those Member States which do not currently operate such indexation, in particular those countries where supplementary pension schemes are of relatively minor significance. Model calculations have revealed that a yearly indexation of 1 % both of preserved rights and of existing accruals might cause additional costs of up to 35 %.[18] Thus, it is not evident whether this rule properly takes into account the additional financial load (see n° 9, third rectical of the Protocol about the application of the principle of subsidiarity). Furthermore, such an increase would probably not meet proven national regulations as well as the intended structure and the function of the supplementary pension system of the Member States (n° 7 of this Protocol). Therefore, even the Commission's intention to promote supplementary pension schemes in all Member States would be put at risk.

As for the notion of "fair adjustment", there might be a lot of detailed questions as to how this can be undertaken. Will a "fair adjustment" be assured if the relevant schemes include actuarial factors which already contain an "anticipated indexation" in calculating the pension rights

[17] See explanations to Article 5 of this Proposal, p. 7
[18] EFRP position paper, imprinted in the German magazine *BetrAV* 2005, p. 678

of the active workers? Furthermore will a "fair adjustment" be assured if DB-schemes link the indexation to the rate of return on assets? Principally, the Commission seems to be of the opinion that this method of indexation is only applicable to DC-schemes.[19] Is it sufficient for a "fair adjustment" if – throughput an individual's career, indexation is only carried out in one of the two phases (i.e. the active period or the period of retirement)? This solution may mean that an indexation within the active period might remove the obligation on the scheme to index during the period of retirement (and vice versa).

Another question is the temporal aspect of this rule. Will all workers who have ever joined this scheme be able to claim for a "fair adjustment"? Or will this rule only apply for new entrants (after a day "x")?

6. Article 6 – Transferability

Article 6 states the rights a worker has to demand a transfer. It should be mentioned that such a right will not be satisfactorily complete if either the new receiving employer or employer pension scheme is not obliged to accept this transfer. The proposal does not stipulate any obligation of acceptance of a CETV. But without any obligation to accept the right to transfer fails to work.

This Article contains details how the transfer should be executed. In contrast to the doubts about the respect of the principle of subsidiarity in the context of Articles 4 and 5, the rules of transferability are to facilitate the cross-border movement of workers. Article 6 thus deals with cross-border aspects, which can be subject of a directive with regards the principle of subsidiarity. In view of the heading of this proposal (Proposal for the directive on improving the portability of supplementary pension rights), this Article can be considered as the actual "heart" of the future directive.

[19] Commission staff working document, p. 39: *"This system seems however not to be applicable to DB schemes"*. However, this statement apparently is only an estimation of the Commission ("*seems*") so that a deviating practise might be accepted

It has to be mentioned that in some languages, there seems to be a collision between Article 6 No. 1 "another Member State", and Article 1, "within the same Member State". These notions are not co-terminus.

Yet, the period of 18 months in which an outgoing worker may request the transfer of his pension rights might be too long. For the sake of legal certainty, it would perhaps be better to provide scope to Member States to shorten this period or to consider it as a more flexible deadline so that a shorter period is possible.

First of all, it should be clear that Article 6 applies only to the cash equivalent transfer value (CETV) and not the entire pension entitlement. An entire pension entitlement can hardly be transferred since it would have to be treated as continuous in the new scheme, which is almost impossible. Effecting a CETV, however, is the best way to complete any kind of transfer and is the nearest one can get to achieving this aim.

Considering the principle of a fair transfer, a rule should be adopted in Article 6 (2) that the CETV is calculated according to the original (transferring) competent pension institution. Thus, specific aspects of each pension scheme can be fully taken into account without penalising the outgoing worker. On the other hand, the new scheme should receive and pass on a CETV according to its own rules.

According to Article 6 (4), administrative costs – being one-off consultation costs – should not be disproportionate to the length of time the outgoing worker has been a scheme member. Regarding the analysis of the Commission that a lot of job changes are done within 5 years,[20] the question to be discussed is who pays the costs linked to portability. The employer? The workers who do not transfer? Or everyone? Is it fair that these supplementary administrative

[20] Commission staff working document, p. 12, graph 2 (Job tenure of people in employment)

costs, caused by early leavers with relatively short periods of scheme membership, should be borne by the remaining workers and / or the employer?

7. Article 7 – Information

According to Article 7 of this Proposal, all workers on request – regardless of whether they want to leave or not – are to be provided with information *"of how a termination of employment will affect their supplementary pension rights."* This information is to be provided in a clear and understandable form (Article 7 (4)). The problem of this rule is the question of liability. Pension matters are frequently complex so that information cannot always be presented in simple plain language. Regarding the question of liability, there might be a further problem of providing information about the future pension benefits particularly to younger worker, since it is not possible to anticipate future developments of the pension schemes in this information. Therefore, Article 7 should perhaps contain a supplementary clause permitting any liability linked to such information is excluded.

Unfortunately, the Directive does not mention any obligation on a receiving institution to provide clear information. It has to be stressed that for the mobile worker, it is of extreme importance to have knowledge as to how his future pension rights will accrue. This information can only be provided by the receiving institution, i.e. the institution to which the CETV is transferred.

8. Article 9 – Implementation

Article 9 (1) envisages implementation being delegated to the social partners for their collective agreements. The question might be discussed, if there is scope to enlarge the **competence** of the social partners so that they will be able to **stipulate even differing rules** by implementing this directive. This enlargement can be justified since social partners (where they are enshrined in law) are **equal partners** who are – at a level of equity – able to define the working

conditions as well as the conditions of their supplementary pension schemes, by means of fair negotiations.[21] Furthermore, the right of social partners to negotiate their working conditions is enshrined in many constitutions of the Member States[22] as well as legislative texts at EU-level like the art. 136 ff. EU-Treaty, Art. 6 of the European Social Charter of 18 October 1961, n° 11 – 14 of the Common Charter of the Fundamental Social Rights of 9 December 1989 as well as in Art. 28 of the EU Charter of Fundamental Rights of 7 December 2000. Social partners thus have established a very strong position in both many Member States and at EU-level so that they should have an enlarged competence as to the implementation of this Directive.

A further question might arise because of the delay for the implementation, being the 1st July 2008. Since this proposal requires unanimity within the Council and has been issued at the end of October 2005, it is hardly possible for it to come into force within the next months. **Thus, the delay for the implementation will probably be reduced to only 2 years, or even less**. Referring to the implementation of the IORP-Directive, which had to be transferred into national law by the 23rd September 2005, such a fixed delay might cause problems to the Member States.[23] This problem could be solved, if the Proposal did not contain a fixed deadline, but a fixed delay (for example of 3 years),[24] linked to coming into force of the directive.

[21] See also Commission staff working document, p. 22: *"A directive would thus allow Member States, social partners and other relevant stakeholders to determine the best way to implement the minimum requirements established at EU-Level adopted to their specific national situation."*

[22] Cp. the constitutions of Belgium (Art. 23 (3) n° 1), Finland (§ 13 (2) n° 3), France (§ 6 of the preamble of the Constitution), Greece (Art. 22 (2) and (3); Art. 23), Italy (Art. 39), Luxembourg (Art. 11 (4), Portugal (Art. 55 ff.) and Spain (Art. 7)

[23] At the beginning of November 2005, only 6 out of 25 Member States have implemented the IORP-Directive in time. Further 5 Member States have indicated a partial transposition to the Commission.

[24] for example Article 12 of the Directive 86/378 EEC

Article 9 (3) finally contains an **exception for unfunded schemes**, whereby they are exempted from the obligation of transferability. This might be an adequate means to take into account the problems of unfunded schemes, which are not only widespread in Germany and Austria, but also in other European countries. However, this **exception carries a time limit of 10 years**, since according to Article 10 (2), the Commission shall draw up a specific report on the application of this exception. The benchmark of this report will be a comparison with workers covered by funded schemes. Considering the different situation of unfunded schemes all over Europe, it is doubtful whether their situation will basically change within the next 10 years and whether therefore; a comparison with funded schemes is adequate.

Additionally, it should be mentioned that – although there is a realistic tendency to suppose that all schemes providing occupational pension rights are meant to be covered by the Directive – it is not clearly stated, which schemes are concerned, and from what time (see as well in this context Article 11, "Entry into force", as well as Article 1, "Scope".). Finally, it is not clear, whether this Directive will apply to all beneficiaries of supplementary pension schemes (i.e. actual workers and former salaried staff) or only to new entrants. The latter solution would be preferable for the sake of legal certainty since otherwise, there is a possibility of supplementary schemes all over Europe facing a sudden and especially unexpected bringing forward of liabilities with a short term rise in costs.

9. Taxation

Although being tackled in the Commission staff working document on several occasions,[25] the problems linked to the different systems of taxations[26] are not mentioned in this Proposal, even if the Commission had already identified the tax barriers as one of the most important obstacles to the free movement of workers within the EU.[27] In order to assure an effective

[25] P. 15, 19 and 58/59
[26] EET system (most common in Europe) ETT or TEE-system
[27] Communication of the Commission „The elimination of tax obstacles to the cross-border provision of occupational pensions", 19.4.2001, p. 7

transferability of pension rights (whether within one Member State or in case of a cross-border job change), any transfer should not have any fiscal consequences. Furthermore, the mobile worker should not have be disadvantaged with regards to his social security rights.

About EAPSPI

The European Association of public sector pension Institutions (EAPSPI) is a group of 20 public sector pension schemes throughout Europe. The members and observers are institutions from the following countries: Belgium, Denmark, Finland, France, Ireland, Italy, Germany, the Netherlands, Portugal, Spain, Sweden, Switzerland and United Kingdom.

These institutions cover the special basic schemes for civil servants or the supplementary schemes for public employees. These institutions are responsible for nearly 19 million active members in the public sector and more than 9 million pensioners.

The main purpose of EAPSPI is to enable their members to improve the reciprocal knowledge of their institutions and that of the social organisation of their respective countries. Furthermore, the association intends to take part in the construction of a social Europe and, in this context, to study the consequences of the opening up of Europe, particularly regarding free movement. In this context, EAPSPI analyses ways and means of improving services offered to their clients (pensioners, active members or employers). To achieve this purpose, the association mainly intends to promote exchanges of expertise and information, involving also the area of products and services linked to retirement and to position itself as a pension expert, in order to develop relations with European institutions and other international organisations.