White Paper on pensions – Position paper Dutch House of Representatives

The White Paper on adequate, safe and sustainable pensions for Europe[1] contains two proposals which have given rise to major concern in the Dutch House of Representatives: the announced review of the IORP-Directive and the announced directive on the portability of supplementary pensions. The House of Representatives has the strong impression that these measures would set aside the principle of subsidiarity.

The Dutch House of Representatives calls forcefully on Parliaments in the other Member States of the European Union to join with the Netherlands in making it clear to the European Commission that they will initiate the yellow/orange card procedure in relation to any review of the IORP Directive or any proposals relating to the portability of pensions.

The proposed review of the **IORP-Directive** could mean that the European Insurance and Occupational Pensions Authority (EIOPA) would begin to exercise supervision over pension funds and that pension funds would be treated as market participants and not as part of a labour agreement. If supplementary pensions were to be dealt with in the same way as private insurance policies this would have an enormous impact on solvency requirements. It would entail much larger buffers for the pension funds, leading to a far more expensive pensions system. Pension entitlements are an element of the labour agreement however, and harmonised regulations at European level and European supervision would be hopelessly complicated with a total of 27 different systems.

The announced proposal relating to the **portability of supplementary pensions** has also raised concerns in the Dutch House of Representatives. The European Commission has previously proposed legislation on this issue, and this has been repeatedly rejected.
Portability is impracticable on technical grounds alone: life expectancy varies enormously around the EU, and so therefore do the reserves required in each

[1] White Paper, An Agenda for Adequate, Safe and Sustainable Pensions for Europe, COM (2012) 55

country. Portability is also impracticable because the financing of pension systems varies from fully contributory schemes via schemes using non-liquid resources and through to funded systems.

Introduction

Dealing with the sustainability of pension systems as a consequence of an ageing society and the current economic crisis are the greatest political challenges that Europe is facing. We welcome the initiative taken by the European Commission in drawing up a White Paper on sustainable and adequate pensions.

The Netherlands also attaches a great deal of importance to a sustainable and adequate pensions system, capable of continuing to offer a decent income for pensioners. In view of the demographic challenges and the situation the capital markets are in, it will be necessary to continue to monitor this situation closely.

It is however a major challenge to find common ground from which to face this problem given the wide diversity of systems and unique national regulations across Europe. It is a material and legally enshrined fact that the principal authority to develop and formalise pension systems rests with the Member States and not with the European Union.

Nevertheless, it is useful to establish common baselines, such as linking pension age and life expectancy rate, a better access to second pillar pensions and a better provision of information

Affordable and adequate pensions are important for everyone. Second pillar pensions are in this regard of great value. Consequently, promotion of those pensions should not be hampered by strict rules.

The Netherlands has a unique and well-developed pensions system. It is vitally important that this system and the authority to take decisions on it can be retained by the Dutch Parliament. The Dutch system is a mixture of financial and social components, which allocates responsibilities to government, the social partners and individual employees, in which the principle of solidarity plays an important role.

All of this forms the basis for the serious concerns expressed by all parties in the House of Representatives after having read the White Paper on Pensions, with regard to the subsidiarity and the proportionality of at least some of the initiatives announced. The House of Representatives holds the opinion that the Dutch pension system might be negatively affected.

This provided sufficient motivation for the House of Representatives to undertake action now. After all, following the actual publication of the proposals, the national parliaments will have a period of just eight weeks to submit their judgements with regard to subsidiarity. Should one third of the parliaments reach negative findings, this will result in the issuing of a "yellow card". In practice the period specified is too short to allow enough parliaments to issue well-founded opinions. An orange card, which would require negative findings from half of the national parliaments and would oblige the European Commission to withdraw the proposal, is even more difficult to reach.

The House of Representatives has deep concerns with regard to the subsidiarity-principle in several elements of the White Paper.

Similar concerns prevail regarding the necessary preliminary questions: is there a European interest at stake and is there European competency?

A number of proposals in the White Paper do appear appropriate. It is wise to assess the sustainability of the labour market and the pensions system given the major demographic changes now taking place. In the view of the House of Representatives the proposal to preserve the entitlements of employees who have worked in a different country for a number of years is also prudent. Employees must be able to collect their pensions in a straightforward manner by means of a tracking service, they must have access to good information and the waiting and vesting periods must not be excessively long, precisely in order to protect them. The exchange of best practices between Member States is also of great importance, and it is gratifying that the European Commission has emphasised the importance of supplementary pensions and the role of social partners and collective systems.

<u>Subsidiarity and proportionality</u>

The Lisbon Treaty and the option of the subsidiarity control mechanism have placed an important instrument in the hands of the national parliaments to help them play their role in European decision-making.

The **principle of subsidiarity** (Article 5 of the Treaty establishing the European Union) ensures that the European Union does not act in areas which are better regulated at national level.

The subsidiarity check can be applied to all concrete legislative proposals. The procedure can result in a **yellow card** if one third of national parliaments object to proposal on the grounds of subsidiarity. The European Commission will then reconsider its proposal.[2]

The procedure can lead to an **orange card** if half of the national parliaments judge that the proposal conflicts with the principle of subsidiarity. If the Council or the European Parliament shares the judgement of the national parliaments the proposal will be definitely scrapped.

Parliaments have eight weeks following publication of the proposal in which to issue their judgements. For a number of reasons, including time pressure and inadequate coordination between parliaments the number of objections required for a yellow card has not yet been reached.

Proportionality is the principle that the form and content of the Union's actions should not exceed that which is necessary to achieve the Union's objectives (Article 5 of the Treaty establishing the European Union).

In the case of a number of the proposals in the White Paper on pensions both these elements are manifestly at issue.

[2] TFEU, Protocol no II art 6.

IORP-Directive

In the White Paper the European Commission has announced that it will bring forward a legislative proposal for the review of the IORP Directive in order to improve cross-border activities, modernize supervision[3] and to maintain a level playing field between the pension funds and the insurance companies covered by the Solvency-II Directive. [4]

There is no **level playing field** for products with substantially different characteristics. The pension funds operate on a non-profit basis with a collective sharing of risk, while for the insurers the capital adequacy of individual policies is primary. Consumer protection is of paramount concern here. For pension funds the primary issues alongside the protection of the pension-holders are fair allocation of risk and intergenerational solidarity.
Insurance products cannot be compared to supplementary pensions.

The **costs** of pension schemes operated by pension funds will not fall, but could rise explosively as a result of demands for excessive guarantees at the level of insurance companies.
This collides with the European Commission's objective of facilitating more cost-efficient second pillar pensions. The costs of strict and highly complex quantitative regulations may well be disproportionate, and would deny employees the opportunity to accrue an adequate pension at the lowest possible cost.

The matter of **subsidiarity** has a very clear relevance here: the design of the national pension system will be put in jeopardy, while it is in employees' interest that agreements, schemes and supervision are as specific as possible.
Harmonisation is in any event impossible due to the entirely different tax systems and differing relationships between first pillar and second pillar pensions.

[3] See White Paper, An Agenda for Adequate, Safe and Sustainable Pensions for Europe, p.13
[4] See White Paper, An Agenda for Adequate, Safe and Sustainable Pensions for Europe, p.17

From the perspective of the **internal market** there is no requirement for additional regulation on top of the existing IORP Directive. The free movement of services is not impeded by the national requirements with regard to pension funds. Free movement of workers is supported more effectively by means of tracking services. And while the existing IORP Directive permits cross-border pension funds, there are only around 80 pension funds (out of a total of tens of thousands of funds) that benefit from this, primarily located in border regions such as Ireland/UK[5]. The European Commission itself also recognises that the possibility of cross-border pension funds is not being taken up.

The European aim of **economic growth and employment** is not served by this either. The pension funds have substantial capital at their disposal. Increased buffer requirements will lead to a reduction in the capital available for the (possibly risk-bearing) investments that contribute to economic growth. Increased buffer requirements will result in higher costs for employers and employees.

Legislation setting down complex and detailed prescriptions for the supervision and for setting up such systems will not aid the sought-for improvement in **access to second pillar systems[6]**. The perverse effect may be a flight to pay as you go schemes, which after all are not regulated. Such a flight has unfortunately already been seen in certain countries. Funds have been nationalised and the government has taken over future pension liabilities. This is not in the interests of sustainable government finance in the long term. This goal would be far better achieved through the exchange of good practices.

Increasing **European supervision** would also bring creeping increases in European responsibilities and risk with it, as it could for example eventually result in financial support being required for pension funds that get into difficulties. Initially this did not appear to be a possible scenario in the case of

[5] See "EIOPA's Advice to the European Commission on the review of the IORP Directive 2003/41/EC" http://www.kps.nl/media/eiopa-bos-12-015-eiopa-s-advice-to-the-european-commission-on-the-review-of-the-iorp-directive-1038.pdf, p.17, para 2.5.2.

[6] See White Paper, An Agenda for Adequate, Safe and Sustainable Pensions for Europe, p.12

banks either, but now that banks can borrow from the ECB with relatively limited security, the Euro Countries are effectively acting as guarantors for one another's banking systems. The view of the Dutch House of Representatives is that it is appropriate for the countries themselves to be and to remain responsible for their own pension systems. The question is why the actual (European) supervision should be falling short.

Increased European supervision would also mean that essential political choices about such matters as the confidence level would be delegated to the supervisory body, a body which will need to have substantial policy freedom with regard to all the different systems. This is undesirable.

An example: the mathematical models for Solvency-II have yet to be finalised. In the case of pension funds there is now talk of a holistic balance sheet, something which is exceptionally complicated. The Groupe Consultatif's Pensions Committee, which brings together European actuaries, regards this as unworkable in practice[7].

[7] See http://www.gcactuaries.org/groupe-news.html

Portability Directive

The Commission has announced to bring forward a proposal for a Portability Directive[8] on supplementary pensions, with the aim of removing impediments to mobility of labour: it must be possible to take your pension with you when you are moving from one country to another.

With regard to technical issues alone, **portability** would run into insurmountable problems:

1. Some countries tax contributions, others tax pension payments. A recalculation would therefore be required on transfer. And what makes it even more complex is that it is possible that a country would need to pay back tax already levied if someone left the country.
2. Portability can only apply if the accrued pension entitlements are covered in their entirety. This is only the case on a large scale in a few countries. Capital can only be transferred from those countries. The funding of pension systems in the EU varies from pay-as-you-go systems via non-liquid funding to fully funded systems.
3. The determination of the transfer value is extremely problematic. Male life expectancy in Latvia is 68 years, whereas in Spain it is 78[9]. The reserves that a Latvian fund needs to hold are considerably smaller than those that a Spanish fund needs to hold. But if it should transfer the entire reserved amount, the Spanish fund will still have far too little to satisfy the Spanish accountancy rules, which are based on their own life tables.

The topic of portability was last on the agenda of the Council for Employment and Social Policy on 9 June 2008. No agreement was reached on the proposal at that time. The subject has not come up for discussion since.
The Commission's (revised) proposal for a directive aimed at improving the portability of supplementary pension rights included substantial measures relating to the acquisition of pension rights (maximum waiting and vesting

[8] See White Paper, An Agenda for Adequate, Safe and Sustainable Pensions for Europe, p.18
[9] See: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Life_expectancy_at_birth,_1994_and_2009_%28years%29.png&filetimestamp=20111201170753

periods and vesting age), their retention (adaptation of sleepers entitlements in accordance with the agreed pension is "fair"), a right of information for active and sleeping participants, and an effective date two years after the adoption of the directive, with a possibility of a five year postponement. The aim here was the promotion of mobility within the national labour market and between Member States.

The House of Representatives has harboured concerns about the portability of pensions for some time now. [10].

If portability is being proposed with the aim of assisting migratory and cross-border workers, then the measure is disproportionate. After all, it requires harmonising systems; otherwise implementation will be exceptionally complicated.

Furthermore, an obvious alternative is available, as the European Commission itself has identified: a good tracking service[11] with proper provision of information. The Netherlands with its pensions register provides an excellent example, which can be shared. If, in addition to this, it can be arranged for waiting and threshold periods to be limited and for deposited funds to be protected, the same objective can be achieved, by using measures that are far less drastic.

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[10] A motion of 21 September 2006 called for no Community regulations in this area (Parliamentary Papers II 74). A motion of 24 May 2007 requested that there should be no agreement with a Directive aimed too unilaterally at the Netherlands and a few countries and which would, with a waiting and threshold period of 5 years, contribute to labour mobility within Europe to a limited extent or not at all (Parliamentary Papers II, 2006/07, 21501-31, no. 125).

[11] SeeWhite Paper, An Agenda for Adequate, Safe and Sustainable Pensions for Europe, p.18

The Dutch Pension System in Brief

The pension system in the Netherlands consists of three "pillars":

- First pillar: all citizens receive a statutory, non-income-related pension, providing everyone aged 65 and above with a minimum income and so protecting them from poverty. All employees contribute to this pillar. This is financed on a pay-as-you-go basis.
- Second pillar: supplementary collective pension schemes are income-related and are financed by and based on agreements between social partners within companies or sectors. Solidarity results from mandatory premium contributions by all active participants. The objective of the second pillar is to provide an adequate income for pensioners. This pillar is capital-funded.
- Third pillar: individual, private pension products with the same objective as the second pillar.

Thanks to the combination of a statutory basic pension and a high level of participation in the second pillar, the consequence of this hybrid system is that the current and future income position of pensioners in the Netherlands is very good, and the level of poverty among senior citizens in the country is very low as a result. The system also delivers diversification and resilience in the face of demographic developments, financial shocks and the like.

The level of the first pillar pension is a little above the statutory social minimum. In combination with the first pillar, the second pillar delivers a high gross replacement rate (close to 90%). Over 90% of Dutch employees participate in supplementary pension schemes. The share of supplementary pensions in the total pension income in the Netherlands is on average 60%. The total portfolio of pension funds in the Netherlands amounts to around 130% of GDP.