OPSG

OCCUPATIONAL PENSIONS STAKEHOLDER GROUP

Advice on implementation of IORP II Directive with regards to cross-border activities of pension funds and cross-border transfers of pension schemes

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EXECUTIVE SUMMARY

As we know, cross-border pension market hasn't yet taken-off in 17 years, since the entry into force of the IORP I Directive: according to the last official available data from EIOPA[1], just 83 cross-border activities of IORPs have been registered, and only 73 are active.

Thus, one of the main goals of the new IORP II Directive is to remove obstacles faced by occupational pension funds operating across borders in Europe.

Therefore, the OPSG is particularly keen that both implementation and interpretation of the new Directive will avoid leading to unnecessary obstacles and complications to cross-border activities.

As stated by EIOPA in its communication on the impact of COVID-19 on the occupational pensions sector *"Occupational pension systems across Europe are very diverse. The IORP II Directive sets minimum prudential rules for IORPs in the EU and, in consequence, prudential regulation varies considerably between Member States."*

However, IORP II states in art 11(1) *"Without prejudice to national social and labour law on the organization of pension systems, including compulsory membership and the outcomes of collective bargaining agreements, Member States shall allow an IORP registered or authorized in their territories to carry out cross-border activity. Member States shall also allow undertakings located in their territories to sponsor IORPs which propose to or carry out cross-border activity*."

[1] EIOPA 2017 Market Development Report on Occupational Pensions and Cross-border Institutions

After the notification period the IORP may start to carry out a cross-border activity in accordance with the host Member State's requirements of social and labour law relevant to the field of occupational pension schemes, including the host Member State's information requirements.

The IORP II Directive introduced rules and regulations on technical provisions, funding and governance. As part of the governance framework, new key functions were introduced including a risk management function. The governance framework also requires IORPs to perform an own risk assessment (ORA) at least once every three years. Such freedom for IORPs to determine their methodology in the context of ORA was also supported by the OPSG, as opposed to using one single harmonized ORA document in Europe. Therefore, an IORP performing cross-border activities must comply with the implementation of the IORP II legislation of its home country. If that home country has introduced minimum requirements regarding the quality of the ORA, which have been previously generally defined by EIOPA for cross-border business, the IORP must comply with these requirements.

As mentioned above the IORP has to carry out the cross-border activity in accordance with the host Member State's requirements of social and labour law. According to recital 3 of IORP II, the own risk assessment introduced by IORP II is not part of social and labour law. The OPSG would consider it unacceptable as non-compliant with the Directive if, in case of a cross-border activity, a host member state argued that the methodology chosen by an IORP for its ORA in line with the aforementioned minimum requirements regarding quality of the home member state, be incompatible with the national requirements of the host member state, and hence an impediment to authorize that IORP to act on its territory.

The home member state approach should be always recognized as legitimate by the host member state and its NCA in accordance with the EU principle of mutual recognition, which is also one of the foundations of the IORP II Directive itself.

Otherwise, if the manner in which an IORP implements its own risk assessment in a home member state will not be accepted by other host member states, we would have a scenario that the new Directive will make the possibility of cross-border activities more difficult, instead of easing them. This would imply additional unnecessary costs, which would be borne by plan members as well.

Unfortunately, it was already noted that this scenario is already happening: in some cases, as noted by OPSG and expounded on this paper, the introduction of the IORP II Directive led to new complications for cross-border activities and cross-border transfers that were not existing under the previous IORP I Directive.

These complications not only result from the implementation of IORP II in local legislation, but also from the requirements from the host member state NCAs and from other rules and regulations of

the member states outside the scope of IORP II not necessarily consistent with the overall EU legal framework.

Examples of complications as a result of the implementation of IORP II:

- In case of cross-border transfers, majorities in excess of those provided for domestic transfers might be required;
- IORPs carrying out cross-border activities might be required to communicate the coverage ratio in accordance with the host country's prudential framework (under the pretext of being part of social and labour law): a framework that is not applicable to those IORPs, as they have to comply with the home country prudential framework;
- Late implementation of the IORP II Directive in local legislation could make cross-border transfers and new cross-border activities impossible to implement, as none would launch such activities before acquiring certainty on the new national legal framework.

Examples of complications as a result of actions taken by the NCAs:

- Delays might occur among NCAs in collaborating with cross-border activities and transfers as long as the IORP II legislation is not yet implemented in the host member's national legislation.
- Delays from NCAs can also occur in granting authorizations to sponsoring employers or multi-employer pension platforms willing to launch cross-border activities.

Examples of complications as a result of other rules and regulations from the member states outside the scope of IORP II:

- New tax legislation based on the host state's prudential funding requirements might be introduced. Such funding requirements are not applicable to IORPs from outside the host member state, as these IORPs have to comply with their home member state prudential framework. This could result in higher taxation of the sponsor's contributions to those IORPs, and finally it would impact, albeit indirectly, also on the plan members' net savings;
- New legislation referring to elements as defined by prudential legislation of the host state might be produced as well. Such legislation, different (and maybe harder) than the home state's legislation would become difficult to be implemented by IORPs running pension schemes in that host member state;
- Fiscal treatment of cross-border transfers might be unclear and as such it would make those transfers quasi-impossible to be executed;
- A home state's fiscal and parafiscal legislation might not take into account the possibility that an IORP executes a host member state pension plan;

PAPER

One of the four main goals of new IORP Directive was to "*remove obstacles faced by occupational pension funds operating across borders*"[2].

After all, the combined provisions of Recitals 11 and 12 of the Directive not only clearly mention the said goal: *"[…] facilitating the cross-border activity of IORPs and the cross-border transfer of pension schemes […]";* but also indicate how this goal should be achieved: *"by clarifying the relevant procedures and removing unnecessary obstacles […]"*[3]; and by implementing the Directive *"in accordance with those rights and principles"*[4].

The present OPSG paper is based on the objective that one guiding line of the interpretation on the way how the new IORP II Directive will be applied in the different member states should not bring unnecessary obstacles to cross-border activities of IORP's and cross-border transfers of pension schemes. The OPSG is aware that the new art 12 of the IORP II Directive has new and tougher requirements for cross-border transfers of pension schemes. Having said that, those requirements should remain consistent with -and not go beyond- the overall EU legal framework.

In other words, in the case of cross-border activities, any request (made to the IORP and the home country NCA) from the host member state to apply rules and regulations from its own implementation of IORP II Directive regarding those aspects which are regulated by the Directive and where the principle of mutual recognition applies should in principle be considered as an unjustified obstacle to cross-border activities, and hence against the overall spirit and goals of the Directive. The IORP II Directive is aimed at minimum harmonization and does not concern issues of national social, labour, tax or contract law, or the adequacy of pension provision in Member States (IORP II recital 3). Therefore, the requirements of IORP II are not part of social and labour law and, in the case of cross-border activities, cannot be defined by the host member state when the principle of mutual recognition applies.

After all, prudential and social and labour law should (remain to) be carefully separated.

The IORP II Directive aims at (minimum) harmonization of the activities and supervision of IORPs. It does not touch on the host member state's national social and labour law on the organization of pension systems (article 11.1 of the Directive); its national tax framework; or when the application of the host member state national rules to IORPs is explicitly permitted by the IORP II Directive itself.

[2] In particular, recitals 2, 3, 4, 9, 11 etc. of the IORP II Directive

[3] Recital 12 of the IORP 2 Directive

[4] Recital 11 of the IORP 2 Directive

As long as, of course, the requirements are in line with article 46 and 47, which contain general principles of prudential law (and hence are not social and labour law).

The IORP II Directive introduced rules and regulations on technical provisions, funding and governance. As part of the governance framework, new key functions were introduced including a risk management function. The governance framework also requires IORPs to perform an own risk assessment (ORA) at least once every three years. An IORP performing cross-border activities must comply with the implementation of the IORP II legislation of its home country. If that home country has introduced minimum requirements regarding the quality of the ORA, which have been previously generally defined by EIOPA for cross-border business, the IORP must comply with these requirements. As the provisions in IORP II are not part of social and labour law (recital 3), in the case of cross-border activities those provisions that also include the own risk assessment, cannot be defined by the host member state.

The OPSG would consider it unacceptable -because it would be non-compliant with the Directive- if, in the case of a cross-border activity, a host member state argued that the methodology chosen by an IORP for its ORA in line with the aforementioned minimum requirements regarding quality of the home member state, is incompatible with its own national methodologies, since that would be an impediment to authorize that IORP to act on its territory.

Finally, it should be stipulated that article 60 of the IORP II Directive on cooperation between Member States, the Commission and EIOPA should help to avoid such risks. This article, which explicitly aims to avoid problems on cross-border membership, provides for an active collaboration of all those entities in order to ensure a uniform and proper implementation of the Directive[5].
The current concerns of the OPSG are based on the new challenges and obstacles to cross-border activities that might derive directly from the IORP II Directive and from the way how the Directive has been implemented by some member states.

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[5] Article 60 of the IORP 2 Directive: Cooperation between Member States, the Commission and EIOPA

1. Member States shall ensure, in an appropriate manner, the uniform application of this Directive through regular exchanges of information and experience with a view to developing best practices in this sphere and closer cooperation with the involvement of the social partners where applicable, and by so doing, preventing distortions of competition and creating the conditions required for unproblematic cross-border membership.
2. The Commission and the competent authorities of the Member States shall collaborate closely with a view to facilitating supervision of the operations of IORPs.
3. The competent authorities of the Member States shall cooperate with EIOPA for the purposes of this Directive, in accordance with Regulation (EU) No 1094/2010 and shall without delay provide EIOPA with all information necessary to carry out its duties under this Directive and under Regulation (EU) No 1094/2010, in accordance with Article 35 of that Regulation.
4. Each Member State shall inform the Commission and EIOPA of any major difficulties to which the application of this Directive gives rise. The Commission, EIOPA and the competent authorities of the Member States concerned shall examine such difficulties as quickly as possible in order to find an appropriate solution.

As an example, a requirement providing that IORPs engaged in cross-border activities should produce a double reporting to members and beneficiaries on its coverage ratio based on both the home state's criteria and host state's ones sounds legally questionable. In such a scenario, IORPs operating abroad should not only provide the information listed by the Pension Benefit Statement from article 39 of the IORP II Directive; but in addition to that, they should provide information about their coverage ratio according to the prudential framework of the host member state that is not applicable to them and which obviously differ from the home member state where those IORPs are located. National social and labour law of the host country can impose additional information to be disclosed to members and beneficiaries but it cannot impose other prudential rules.

Notwithstanding the fact that information requirements are only minimally harmonized (Art 36.3) and are to be applied according to the law of the host country (art 11.6 and, art 36.2 lett. e), the fact of declaring that such a specific additional requirement is to be considered as part of national social and labour law seems to be questionable: not only because the new Pension Benefit Statement already assures sufficient and accurate information to members and beneficiaries[6], and such a double reporting imposed to IORPs with cross-border activities might rather lead to more confusion to the recipients and add unnecessary additional costs ultimately paid by savers; but also, because:

- such a new obligation would be specifically and solely addressed to IORPs from other member states and operating cross-border activities, considering that such provisions on double reporting would be obviously not be applicable to IORPs acting locally. This situation appears quite different than the aforementioned national information requirements requested in addition to the EU minimum ones, and generally applicable to national and foreign IORPs operating in a given member state.
- this obligation, specifically addressed to foreign IORPs operating cross-border activities in a given member state, would be introduced on occasion of the implementation of the new IORP Directive, as to say 17 years after the first IORP Directive of 2003, when such requirement was not required for IORPs operating cross-border activities in the same member state during all that time.

A very high majority of both members and beneficiaries as a requirement to accept a cross-border transfer of their pension schemes while it is not required for a domestic transfer seems questionable as well. It is true that article 12(3) of the Directive provides for a "majority of both members and

[6] With this regard, recital 66 of the IORP 2 Directive is quite clear on its point: "For members, IORPs should draw up a Pension Benefit Statement containing key personal and generic information about the pension scheme. The Pension Benefit Statement should be clear and comprehensive and should contain relevant and appropriate information to facilitate the understanding of pension entitlements over time and across schemes and serve labour mobility".

beneficiaries" as a condition to accept cross-border transfers and, moreover, the Directive states that the majority can be defined by the member states (Art 12.3 lett. a). However, a super-majority requirement will make, in practice, cross-border transfers from that member state almost impossible in the case that the majority required for a transfer to an IORP located in the host member state is weaker. Member states should not impose super-majorities on cross-border transfers if such super-majorities do not apply to domestic transfers.
Otherwise, the general EU principles of no discrimination based on the nationality would be violated.
When instead member states do not request any majority rule for domestic transfers, it would make sense that they just apply a simple majority rule for cross-border transfers; and if they would decide to impose stronger majority rules for those, they should then apply the same (high) majority rules for domestic transfers as well, because -here again- pure domestic transfers should be not treated better than cross-border ones.
Such national legislations might generate serious practical consequences on the market: IORPs carrying out cross-border activities under the previous IORP Directive, might even stop promoting their operations as a consequence of the new implementation laws of the IORP II Directive.

Late implementations of the IORP II Directive in local legislations would make cross-border transfers and new cross-border activities quasi-impossible to implement. Late implementation leaves uncertainty for the IORPs with cross-border activities in the host country but also for the NCA in the home member state of the IORP.

New taxation based on a host country prudential framework's funding requirement could imply that the host member state sponsors of IORPs running cross-border activities in that country could end up paying much higher taxes on the contributions compared to the taxes they would pay if the IORP was located in the host member state and again, albeit indirectly, also the plan members' net savings would be undermined. In such a case, a discrimination based on the nationality of the IORP, together with a violation of the freedom of providing services in the EU could arise. The OPSG is aware of the fact, that all member states have full tax autonomy and hence are free to impose taxes, change their tax laws etc..

In addition to new concrete measures aimed at encouraging cross-border activities, the sanction of actions and behaviors legally inconsistent with the EU current framework should represent the very first step to keep cross-border activities alive.

CONCLUSIONS

- The IORP II Directive only prescribes minimum requirements on governance, funding, information and investments, and additional provisions on these matters might be inserted by member states for their IORPs.
- However, insofar as the European requirements prescribed by the Directive are attained by IORPs, by leading *ipso iure* to those standards considered as satisfactory by the EU authorities, those standards should be accepted by the other member states as well, according to the EU principle of mutual recognition. According to this principle, an IORP regulated in an EU home member state (for example with respect to its minimum requirements regarding the quality of the own risk assessment of an IORP, which have been previously generally defined by EIOPA for cross-border business), should be recognized as valid by the other host member states, and hence allowed to engage in cross-border activities in the national jurisdictions of host member states.
- Therefore, any discriminations between IORPs located in other home member states should be prohibited, and no additional requirements or adaptations to local provisions could be required by host member states from such IORPs trying to set up cross-border activities in that member state in areas within the scope of the Directive unless those local provisions are part of social and labour law and tax framework of the host member states (granted that a member state will not create "ad hoc" social and labour legislation in implementing the new Directive with the only aim of creating new obstacles to cross-border activities);
- Some adaptations to host member state rules are explicitly permitted by the Directive itself.
- The OPSG, concerned that problematic misinterpretations leading to the aforementioned risks, and aware that in some cases the manner in which the new Directive might be implemented would hamper cross-border activities of IORPs in practice, recommends that all the NCAs and the member states respect this guiding principle, and that the European Institutions and EIOPA to be vigilant on this issue.
- Beside this, the OPSG recognizes that the new Art 12 IORP on cross-border transfers is more burdensome and complex than article 11, but despite that, a different legal

treatment based on the nature of the transfers (domestic vs cross-border) should be interpreted as a violation of the EU general principle of non-discrimination based on nationality.

- Otherwise the new IORP Directive, instead of attaining its goal of making cross-border activities of pension funds easier, will paradoxically become a new tool to make them more difficult.