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Pensions Portability Directive

This note outlines the position taken by the Groupe Consultatif Actuariel Europeèn on the Portability Directive and the background of the Directive

Groupe Consultatif position

The White Paper on *An Agenda for Adequate, Safe and Sustainable Pensions* published on 14 February 2012 included the following action point: “The Commission will… resume work on a pension portability directive setting minimum standards“.

The Groupe is strongly supportive of the requirement in the draft Directive that "dormant" pension rights receive fair treatment. We consider that defined contribution (DC) entitlements of former employees should have access to the same investment options or interest guarantees that apply to current employees. For defined benefit (DB) entitlements, the amounts calculated at date of leaving should maintain their real value i.e. there should be a requirement to provide annual adjustment ("revaluation") of the benefit in line with a price or wage index up to the date on which payment of the pension commences. During periods of recession or deflation, these indices might fall, leading to a downward adjustment in accrued rights: we consider that this is consistent with the principle of "fair treatment" relative to employees, who may suffer pay cuts during such periods. In some Member States, there is currently provision for revaluation in line with an inflation index subject to a fixed maximum in each year (e.g. 4% in Ireland) which we consider to be a reasonable and pragmatic approach.

The Groupe always recognised that enforcing transferability of pension rights would not protect mobile workers if the rules governing vesting and revaluation of acquired rights were not at an appropriate level.

Where the lines should be drawn is largely a political decision: we accept that for practical reasons it is not unreasonable to have some minimum waiting/vesting periods so that short service employees do not have very small preserved entitlements which may be eaten away by charges, or otherwise impose a disproportionate administrative cost on IORPs. We would however caution against the introduction of age-related limits as included in the 2007 draft of the Directive in case these are held to constitute age discrimination.

The Groupe does not accept that transferability (once you have minimum vesting/revaluation provisions) between funded schemes is "technically difficult" although there are in some cases legal or tax obstacles which may need to be addressed (and presumably any tax penalties on cross border transfers that do not apply to domestic transfers are in breach of the Treaty of the Functioning of the European Union). In particular, transferability of DC rights across borders should not pose any "technical" problems (and most new pension accrual in Europe is DC).

The Groupe supports another proposal in the White Paper which would enable mobile workers to keep track of their deferred benefits in different countries which is the development of pension tracking services. If implemented successfully, this may remove some of the perceived demand for transferability.

Please see addendum for more information regarding the Groupe's views on transferability.

The Groupe:

- Supports the initiative to introduce a consistent, Europe-wide limit on the minimum conditions that individual Member States may set for the acquisition and preservation of benefits, but would recommend that such limits are not age-related in case this is considered discriminatory

- Supports the development of pension tracking services to enable mobile workers to trace their deferred benefits in other countries

- Notes that, although the directive does not include provisions in relation to transferability of entitlements

    - There are no technical impediments to DC transfers

    - The calculation of transfer values in respect of DB rights is not complex but we do not consider that a common transfer value basis across Europe is practical at present

    - Offers to assist in the discussion of this aspect if and when the Commission wish to progress it.

Background:

In October 2005, the European Commission introduced a proposal for a Directive on *"improving the portability of supplementary pension rights"*. After considerable discussion and revision over several EU presidencies, an amended proposal was issued in October 2007.

The key driver is to ensure that lack of transferability of pensions is not an impediment to mobility of labour. The original proposal included a requirement that on leaving an employment, a worker must be given the right to transfer his or her acquired pension rights within the State or to another Member State, and set out a broad framework for the calculation of transfer values.

However, this was removed from the amended proposal – the preamble to the latter referenced the view of the European Parliament "to shift the focus …onto the acquisition and preservation of dormant rights and away from provisions for transfers. The European Parliament considered that the introduction of a compulsory transfer option at this time would place too great a burden on some supplementary pension schemes and would, furthermore, cause considerable technical difficulties." The relevant article was removed in the amended proposal and the title was changed to **"Proposal for a directive on the minimum requirements for enhancing worker mobility by improving the acquisition and preservation of supplementary pension rights"**.

The amended proposal focused on three aspects:

- Acquisition of rights (waiting periods, minimum ages, vesting periods)
- Preservation of "dormant" rights (revaluation between leaving and retirement)
- Information on dormant rights

In relation to acquisition of rights, the amended proposal set specific minimum requirements for

- Minimum age for entry to plan – 21 years
- Maximum waiting period (unless the minimum age has not been reached) – 1 year
- Maximum vesting period i.e. before acquiring a right to benefits on leaving the plan: 1 year if the member has attained age 25, 5 years if the member is under 25.

Where a member leaving employment does not have vested rights, the scheme must reimburse him/her the contributions he/she has paid, or which were "paid on his/her behalf in accordance with national law or collective agreements or contracts" and in a defined contribution arrangement where the member bears the risk, the "investment value arising from these contributions" (presumably whether this is negative or positive).

The proposals in relation to the preservation of dormant rights are:

- Member states must ensure that vested rights can remain in the scheme (although they can set a threshold below which the value of vested rights can be paid to the member on leaving)
- The initial value of these rights is calculated at the termination of employment
- The rights, or their values, must be treated
    - In line with the value of rights of active members or
    - In line with pensions in payment or
    - By other means which are considered fair treatment, such as
        - set as a nominal sum
        - increased at a rate of interest or in line with return on investments
        - adjusted in line with inflation or salary increases (which may be subject to a 'proportionate' limit – set out in national legislation or agreed between the social partners).

The proposal also includes some information requirements in addition to those arising under the IORP Directive. Active members should receive, on request, details of

1. conditions governing the acquisition of benefits and how their benefits would be determined on leaving service
2. the value of their vested rights
3. the future treatment of "dormant" rights after leaving .

Former members with deferred rights should receive on request details of the value of their rights and the conditions governing the treatment of their benefits.

The draft proposal provided for implementation by Member States within 2 years of adoption but Member States could be permitted a five year period to implement the acquisition and preservation requirements. It also requires a review to be undertaken by the Commission every 5 years after the implementation date. The first report shall "review the conditions of transferring capital representing workers' supplementary pension rights".

However, the amended proposal was not agreed by the Council as some Member States considered that the proposals were unacceptable.

Pensions Committee

January 2013

ADDENDUM – **Visions on Transferability**

We realise that physical transfer of rights is not on the agenda. In case of physical transfer we could think of two basic approaches:

1. Preserving pension value for the mobile employee
   Using a common set of valuation rules and assumptions on a European level when dealing with a transfer. The accrued pension that is to be transferred is valued on this standard basis. The amount that comes out is transfer sum. The receiving scheme translates this transfer sum back using the same standard valuation assumptions into the types of pension of this receiving scheme. This would lead to actuarial equality of the transferring rights before and after the transfer. So it would preserve the value of the accrued pension for the mobile employee. The difference with the local valuation is then to be borne by either the scheme or the sponsor or both. This is true at both the transferring and the receiving end. Differences with the local valuation basis should not be a problem if the number and size of transfers in equal the numbers and size of transfers out.
2. Financial neutral transfer sum on both ends (higher or lower pension for the mobile employee)
   The transfer sum is based on the local valuation of the leaving scheme. At the receiving scheme this transfer sum is translated into the types of pension of this receiving scheme using the local valuation rules of the receiving scheme. This approach will be cash neutral for both the leaving as the receiving plan/sponsor. Any difference will lead to a higher or lower value of the transferred pensions for the mobile employee.

The Groupe undertook a survey of the then EU member states in 2001 and this concluded that the approach to calculating transfer values from DB plans (and the responsibility for determining the assumptions) varied significantly across Europe. We then proposed principles for the calculation of transfer values from defined benefit plans which were:

> 1. The Transfer Value should be the fair value of the benefits to which the member would be entitled as a deferred pensioner on leaving service.
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> 2. Allowance should be made for any entitlement to
>
> a) Revaluation in the period to retirement
>
> b) Indexation in the period post retirement
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> c) Benefits for dependants on death before or after retirement
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> 3. The Transfer Value should be based on the vested benefits.
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> 4. The mortality tables used should be standard tables which are generally accepted in the member state, unless scheme specific tables can be statistically justified on the basis of adequate scheme experience data.
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> 5. The discount rate should reflect market rates of return expected from classes of asset appropriate to the liabilities, having regard to duration, and revaluation and indexation provisions. Relevant asset classes would include government and corporate fixed-interest bonds, government and corporate index-linked bonds, equities and property.

The Groupe noted that there was considerable scope for different views in relation to the assumptions to be adopted, in particular whether the rate of interest used in placing a value on the acquired rights should represent a market rate i.e. the yield on an appropriate bond, or the expected cost to the plan of providing the benefits which would use a higher interest rate allowing for expected outperformance of the assets held by the plan. This is of course now a very topical issue, with the added complexity of wide spreads in bond yields and the ongoing debate surrounding market consistency.

Another issue which is now more relevant is the disparity in funding levels which in practice will inhibit the payment of a "full transfer value" in many cases.

Although we had some tentative discussion initially about a standard transfer value basis across Europe, noting the difficulty of different longevity expectations between Member States, this now seems impractical unless and until we have harmonised technical provisions. It is an open question whether this will happen before or after the 5th anniversary of the implementation date of the portability directive when a review of transferability will be undertaken![1]

One aspect which has come more strongly into focus with the decline in some countries of DB provision is the practice of offering DC provision for transfer payments received, even if accrual for actual service is DB. Why should an employer be expected to underwrite a promise in respect of perhaps 20 years' service with a previous employer? This may be done in cases of transfers of mobile employees within multinational groups, but such cases are not the focus of the proposal.

We do not consider that a common transfer value basis across Europe is practical at present.