
The EU and supplementary pensions

Instruments for integration and the market
for occupational pensions in Europe

Igor Guardiancich and David Natali

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1. Introduction

A general increase has taken place in the role and weight of supplementary pensions in the provision of protection against old-age and other risks. In Europe a development in this direction is observed in countries with different pension systems and institutional backgrounds. In both ‘veterans’ and ‘newcomers’ (the former with a long tradition of supplementary schemes interacting with public basic pensions; the latter with more recent innovations consistent with the progressive curtailment of public pensions and the parallel increased role of second- and third-pillar funds) supplementary pension funds do in fact play an important role in protecting against old age. The changing balance between first, second and third pillars (with a shift from public forms of old-age protection to occupational and individual schemes) is paralleled by the European Union (EU) action in shaping pensions policy, with a particular focus on supplementary funds.

This paper aims to shed light on the complex map of pensions policy across the EU. One focus will be on the growing role played by European integration in the field (whether through legislation or through other forms of hard and soft coordination), while attention will also be paid to the *status quo* of the European pension markets. In the case of occupational pensions, there indeed exists considerable scope for interaction between these two issues. In many countries, occupational funds represent a key institution in social protection (and pensions in particular). The EU, meanwhile, has intervened to foster completion of the single market for private insurance with a specific reference to pension funds. As such, the case of occupational pension funds is of particular interest in any attempt to assess the role of the EU in the pensions field, the scope for development of a truly EU common market in pension funds (through the setting up of cross-border schemes) and the present and future challenges to this particular aspect of pensions policy.

Section one briefly summarises the key policy tools that the EU has used to intervene in pensions policy. Reference is made to direct (and positive) integration through legislation on fundamental social rights, anti-discrimination and equality; direct (and negative) integration in order to grant freedom of movement for workers and provision of services through the market-building process; indirect pressures through the completion of a single market in occupational pensions; indirect but hard coordination through the Stability and Growth Pact and direct (but soft) coordination through the OMC process on Social Protection and Social Inclusion. This section is particularly focused on the content and expected outcomes of Directive 2003/41 on Institutions

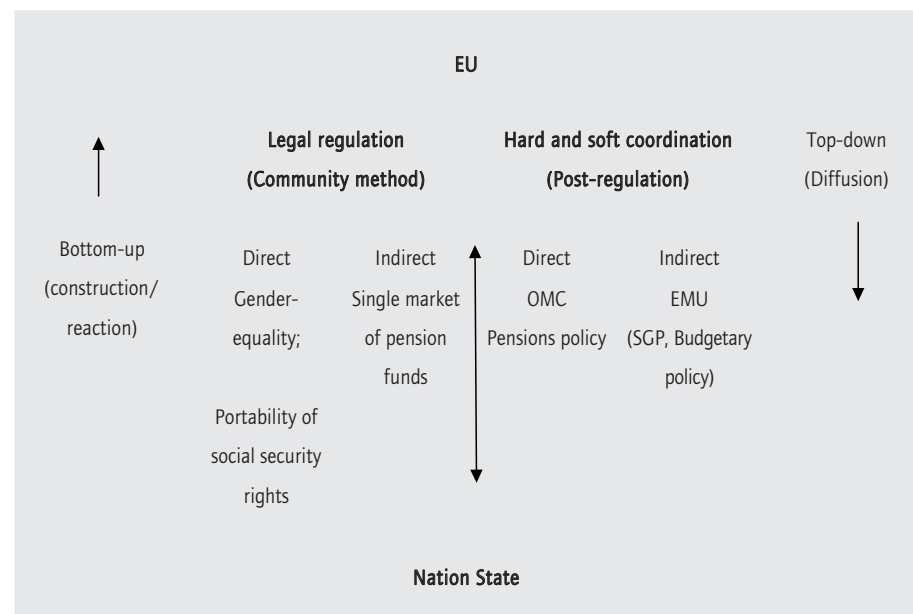
for occupational retirement provisions (IORPs), the purpose of which was to boost the single market for occupational pensions. Section two provides a summary of occupational pension markets in both western and eastern Europe. Section three looks at the first steps in the development of cross-border occupational funds in EU countries and the way Directive 2003/41 has influenced such trends. Section four concludes.

2. The EU role in the field of pensions

While European integration in the realm of pensions has been traditionally modest, some long-term developments may have the effect of limiting national prerogatives (Pochet, 2005; Goetschy, 2006). The EU has fostered domestic changes through market integration and the hardening of fiscal, monetary and economic discipline, alongside the coordination of national social and employment policy. Moreover, European integration has directly affected the boundaries of social citizenship. Consequently, the traditional link between social rights and (national) territory has become much weaker (Ferrera, 2005 and 2007).

Evolving EU social competence has been mainly centred on two instruments: regulation and post-regulation (consistent with the coordination rather than the harmonisation of national policy) (Levi-Faur, 2006) (Figure 1).

Figure 1 Main EU action in the field of pensions



Source: Natali (2008)

Given the limited financial resources of the EU (consistent with rigid budget constraints), rule-making has been the most important instrument of governance at that level. The proliferation of directives and regulations and the key role played by the European Commission and the European Court of Justice are all an expression of increased regulatory powers for the EU (see Majone, 2002). The 'Community' method produces rules that are legally binding across all Member States. Among the EU modes of governance, and despite implementation deficit and evasion, this approach is conducive to the greatest degree of influence (Citi and Rhodes, 2007). In the field of retirement policy (and in the broader area of welfare), the 'Community method' has led to various forms of direct and indirect pressure towards integration (Figure 1).

Pension regulation was initially designed to foster *direct (and positive) integration*. Social policy initiatives have been pursued by central institutions in order to promote fundamental social rights, anti-discrimination and equality. Since the signing of the Treaty of Rome, European gender policy has represented one of the few social policy mandates at European level. From the 1960s onwards European action in this field has consisted of secondary legislation (together with Treaty revisions) and ECJ rulings. The normative foundation of this intervention was originally the principle of equality on the labour market. This principle was fostered for economic and social reasons, gender equality being an economic necessity in order to restrict gender barriers to labour market participation, and thus reflected a distinctly liberal understanding of equality as sameness (Mac Rae, 2007). On the other hand, the Treaty and its subsequent application has allowed the development of greater social understanding, at least an extension of the principle beyond the pay issue to include broader social rights (Natali, 2008). In line with Leibfried (2005: 256), we argue that the scope for European initiatives in the field of anti-discrimination is expanding and that EU legislation is as extensive as was federal social policy in the USA on the eve of the New Deal. Moreover, as shown by the cases of Belgium and the UK, ECJ rulings on gender equality have exerted considerable influence on the national regulation of both statutory and occupational pension schemes (Mabbett, 2000; Marier, 2007).

In parallel, EU regulation has led to *direct (and negative) integration* in order to grant freedom of movement for workers and provision of services through the market-building process (Leibfried and Pierson, 1995 and 2000; Leibfried, 2005). The aim of the EU has been to facilitate intra-European migration and reduce restrictions on labour mobility. As argued by Ferrera (2005), the development of the EU regime on social security coordination has represented a further expansion of social rights beyond the limits of domestic territory. While implementation of coordination of social security within the EU has been at the core of a struggle between European institutions and national governments (in terms of limited implementation and legislative counter-acts), this process has served to redefine the boundaries of social citizenship. It is shaping the scope of, and access and entitlements to, social rights. Member States may no longer limit social benefits to their citizens, restrict the provision of such rights to their territory, or prevent other social policy regimes from competing on their own territory. As such, national welfare states have lost

much of their sovereignty. In April 2004 Regulation 883/2004 was adopted ‘on the right of citizens of the EU and their family members to move and reside freely within the territory of the Member States’. The aim of the new legislation was to simplify matters for citizens without disproportionately complicating the tasks for administrations, as well as to preserve the key principles of the previous rules, namely, the unity of the applicable legislation, the principle of *lex loci laboris*, equality of treatment, and the possibility of exporting social security rights (Ferrera, 2005). Compared with the Regulation of 1971, the more recent piece of legislation was expected to result in important simplifications (Pochet, 2007; Natali, 2008). A number of broad principles for the coordination of social security were brought together in the general provisions, while rules for determination of the application of the legislation were simplified. In particular in the case of family allowances, the distinction between employees, self-employed workers and pensioners was removed. New rules were introduced on (compulsory) administrative cooperation between Member States, particularly for the determination of social rights for the interested parties.

Completion of the single market for private insurance has been a further line of intervention consistent with *indirect pressures* that do not legally require but nonetheless encourage the adaptation of national retirement programmes (Leibfried, 2005). Here again the legal and normative foundations accord with a liberal understanding of economic integration, namely, market liberalisation and promotion of competition. Directive 41 of 2003 on the activities and supervision of institutions for occupational retirement provisions has opened up more room for an EU market for supplementary pension funds. But Treaty revisions (with reference to the special character of social dialogue) and decisions by the ECJ (recognising the special character of pension schemes set up by social partners through collective agreements) have led to the acknowledgment of key limitations to such principles. As shown by Mabbett and Schelkle (2007), various cases have proved the Court’s commitment to integration but in a new fashion more consistent with EU social goals.

A further set of instruments has consisted of post-regulation (aiming at the coordination of national policies) to secure ‘structural coupling’ between different autonomous social sub-systems (mainly the economy and society). These modes of governance are mainly (or exclusively) based on non-legislative instruments (e.g. common guidelines, national action plans, peer reviews, joint evaluation reports, recommendations, and in some cases sanctions). Instruments of soft governance are assumed to be effective in shaping the behaviour of those at whom they are directed, without the use of formal law (Trubek and Mosher, 2003; Zeitlin, 2001). Two main forms of post-regulation are referred to in the next chapter. The requirements for budgetary discipline laid down by the Stability and Growth Pact (SGP) – within the broader Economic and Monetary Union (EMU) – represent a source of *indirect pressure* on pension institutions. The coordination of pension reforms through the Open Method of Co-ordination (OMC) is a *direct* and soft version of integration (Leibfried, 2005).

2.1 Completion of the single market for insurance: the case of Directive 2003/41 on occupational funds

The first step in the creation of an internal market for insurance was taken in the 1970s.¹ During that decade a first generation of Directives laid down the conditions for freedom of establishment – that is, the opening of branch offices and agencies in any Member State (see Ferrera, 2005 for an overview). The first Directives did not consider the case of supplementary pensions.

In the 1980s, the regulation of supplementary pension schemes further attracted the attention of the EU. This was a time when three new countries (the UK, Ireland, and Denmark) had acceded to the Community and these were countries in which supplementary pension schemes played an important role. Directive 88/357 and Directive 90/619 laid down the conditions for the freedom to provide services, allowing insurance carriers to cover a risk located in the territory of another Member State without having to set up a branch office or agency. The application of such freedom, however, remained limited to policyholders who did not require special protection by virtue of their size, status, or risk (such as transport risk or fire).

In the context of the Single Market project and EMU, the Commission started to take legislative initiatives in the 1990s both on cross-border coordination of supplementary schemes and on free circulation of the capital of, and services provided by, occupational pension funds.² In parallel, the ECJ was active in clarifying the scope of the Directive's application. While social security was clearly excluded from the completion of the single insurance market, a body of case law on implementation of EU competition law was further developed. In this respect the Court acted to defend the principle of social solidarity (Mabbett, 2000). One of the first rulings was in the joint cases of *Poucet and Pistre*, in 1991. In both cases, the Court found French pension schemes for artisans and sickness and maternity insurance for the self-employed to be not an economic activity (i.e. not an 'undertaking') and therefore not subject to competition law (Leibfried, 2005). A subsequent and highly relevant ruling of the Court was the *Albany Case* of 1999.³

1. The first Directive (73/239/EEC) dealt with the issue of the regulation of insurers operating in different countries through a regime whereby each Member State in which a branch was located undertook financial oversight of that branch, while the Member State where the head office was located had additional responsibilities (Mabbett, 2000: 242).
2. Directive (98/49) defined basic criteria for safeguarding supplementary pension rights: acquired rights must be maintained in the case of cross-border movement by workers; all EU nationals must be equally treated; and benefits are exportable to the territory of other Member States.
3. A textile company (Albany International BV), followed by others, refused to pay contributions to its industry pension fund, arguing that this obligation violated EC competition law. The case reached the ECJ, which recognized both the 'undertaking' nature of the fund and the absence of intergenerational solidarity. This notwithstanding, in *Albany* the Court ruled in favour of the pension fund because of the presence, in the scheme under scrutiny, of distributive solidarity arrangements and its nature as an outcome of collective bargaining, a practice that could not be considered as violating antitrust norms under Treaty rules. As Mabbett (2000) puts it, the Court's judgment referred to Article 137 of the Treaty of Amsterdam, which provides for the promotion of the right of association and collective bargaining while the promotion of social

The first attempts to regulate occupational retirement provisions failed miserably. An initial proposal made by the Commission in 1991, largely inspired by British doctrines and practices, failed to win unanimous support in the Council, mainly due to French opposition. In 1995, in the context of creating the Single Market, a new directive on institutions for retirement provision had to be withdrawn under pressure from several Member States (Pochet, 2003). A new phase therefore started with the setting up of the High-level Group on the free movement of people and, in 1997, with the publication of the Green Paper on complementary pensions (CEC, 1997a).

As explained by Haverland (2007), the Commission aimed to liberalise the market for supplementary pensions by introduction of the key concept of 'prudent person principle'. This is the typical regulation used in Anglo-Saxon countries where few quantitative restrictions on investment are applied. In line with this principle, Member States are not allowed to require prior approval of investment decisions by the fund managers.⁴

In line with the Union's aspiration to increase opportunities for a free market in services, Directive 41 of 2003 aimed to facilitate a pan-European market for occupational retirement provision and create a framework for the efficient operation of pension institutions and the defence of their members' interests.⁵ But this did not lead to full liberalisation as member states with more restrictions on investments largely succeeded in defending their domestic rules (especially for occupational schemes with solidarity aims). Moreover, the Directive explicitly excludes from its scope of application both first-pillar schemes ('social security schemes which are covered by Regulation no. 1408/71') and, in general, institutions that operate on a PAYGO basis.

More specifically, the Directive aims at protecting the members and beneficiaries of pension funds. Institutions providing supplementary pensions, in fact, will be subject to detailed rules of operation and safeguards for their members. Institutions for occupational retirement provisions (IORPs) have to be registered in a national register run by persons of good repute, and must have properly constituted rules, while their liabilities must be calculated and certified by specialists. Members and beneficiaries have then to be properly informed about their rights, the situation of the institution and the terms of the scheme. Competent authorities must conduct supervision of IORPs through inspections and other powers of intervention (for a summary of the Directive see Arnot, 2004).

dialogue is a broader goal of the Agreement on Social Policy. Moreover, the Court endorsed the Dutch government's position, finding that the restriction on competition (consequent upon the statutory power used to make affiliation to the pension scheme compulsory for all employees in the sector) aimed at a social purpose.

4. Most of Scandinavian and Continental countries adopt stricter limitations on the investment of pension funds, with precise definition of the financial instruments that are authorised (e.g. bonds, loans, etc.).
5. IORPs are defined as "institutions, irrespective of their legal form, operating on a funded basis, established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity" (Article 6). The new legislation is to apply to cross-border schemes but also to occupational schemes in one Member State only (but each country may exclude funds with fewer than hundred members).

Secondly, the Directive requires IORPs to be sufficiently funded. Sufficient and appropriate assets are required to cover the technical provisions (e.g. the liabilities of the schemes), with each Member State expected to impose detailed requirements. Occupational schemes must be fully funded and, in the case of a financial deficit, the scheme has to adopt a recovery plan, an exception that is not allowed for schemes undertaking cross-border activity, which must be funded at all times.

Thirdly, the Directive enables institutions to accept sponsorship by a company located in another Member State and to run a pension scheme for it. The new legislation allows for mutual recognition of Member States' supervisory regimes. An IORP can manage the schemes of firms located in other Member States by adopting the prudential rules of the country where it is established (a practice referred to as 'home-country control'). At the same time, the social legislation of the host Member State (applicable to the relationship between the sponsoring undertaking and the members) will continue to apply (Castegnaro and Jung, 2003).

Fourthly, the Directive allows IORPs to follow an investment strategy tailored to the characteristics of their pension schemes. Pension institutions, in other words, have to follow the 'prudent person principle'. Assets must be invested in the best interest of members and be widely spread at all times to guarantee the security, quality, liquidity, and profitability of the portfolio. Moreover, investment in shares and risk capital should not be unduly restricted. Each Member State has the opportunity to subject occupational scheme institutions established within its jurisdiction to more detailed investment rules, but would not be able to prevent them from investing up to 70% of their portfolio in shares and corporate bonds and up to 30% in currencies other than those of the future pension liabilities. The Directive makes it possible for host Member States (where the company sponsoring the pension fund is located) to ask home Member States (where the pension institution is established) to apply quantitative rules to assets held by cross-border pension schemes.⁶

As far as its (potential) outcomes are concerned, the new legislation involves occupational pension institutions (second-pillar provision) covering about a quarter of the EU labour force and manages assets amounting to more than 20% of EU GDP (for details, see Table 2). As a consequence, the new legislation was expected to be of major significance. Yet it potentially leaves a certain degree of freedom to the Member States. First of all, the Directive provides a general framework for the activities of occupational schemes. While it does not require members to introduce specific arrangements, for example about the tax treatment of

6. UNICE (now Unifil), the organisation of industrial and employers' confederations of Europe, strongly favoured the 'prudent person principle', while the European Trade Union Confederation asked for more stringent regulation (according to the proposed 'Code of Good Practice' defined in 1998). That code stressed the need for the participation of workers' representatives in the management of pension funds (Esposito and Mum, 2004).

contributions, funds and benefits, it does enable pan-European institutions to operate according to the Financial Services Action Plan for the years 1999-2005 (Arnot, 2004). This is expected to be one of the major foreseeable effects. Its goal is to optimise the conditions in which these institutions operate and create a framework for prudential supervision.

As shown by Section three below, this first step towards the harmonisation of (supplementary) pension institutions has proved limited and leaves Member States ample room for manoeuvre in its implementation (Haverland, 2007). All countries will implement the EU legislation in this field through their own legislative process and it is worth stressing the different perspectives on the potential outcomes at national level. In countries like the UK, the Directive is expected to have a limited effect on existing barriers to a common system of occupational schemes, if not to constitute a further threat to the development of a single (and efficient) pension market (Thompson, 2004). To sum up, it will provide a 'passport' to IORPs wanting to accede to the Single Market.

3. The market for occupational pensions in EU-27

But what is the real shape of the pensions market in Europe? With respect to occupational pensions, the EU-27 is a very fragmented and heterogeneous market. Due to the social role that second pillars play in national economies, they represent a bastion for the legitimacy of democratic welfare states and are hence part of a patchwork of different legislative, societal and ultimately cultural traditions (e.g. Esping-Andersen, 1990).

With respect to the period when private pension insurance was first introduced as a complement to public pensions, the literature, as stressed before, makes a distinction between private pension ‘veterans’ and ‘newcomers’ (see Bonoli, 2003: 400-402; Meyer and Bridgen, 2007: 24-27).⁷ The former are usually countries that followed the Beveridgean tradition of providing flat, universal and frequently tax-financed benefits. These welfare states fulfil the fundamental goal of poverty alleviation but do not allow for adequate consumption smoothing during old age. Hence, they soon responded to the need for greater income smoothing by developing voluntary, and at times quasi-mandatory, occupational pension systems (the United Kingdom, the Netherlands, etc). The newcomers, on the other hand, are situated within the Bismarckian tradition, where insurance is mainly aimed at dependent employees. Contribution-financed insurance schemes are characterised by generous income-related pension benefits, the main purpose of which is maintenance of the accustomed living standard of the insurees. Coverage is limited and those who fall outside the system are covered by social assistance schemes. Insofar as Bismarckian systems are tailored for middle- and high-income workers, supplementary pension schemes started appearing when the era of ‘permanent austerity’ kicked in with the fiscal crisis of excessively generous public pensions.

As a small departure from the literature, this report will analyse separately the Old and the New Member States. For the EU-15 the above rationale is employed, as pension veterans are separated from newcomers. The New Member States – ten of which are post-socialist countries – are all newcomers, but, instead of developing occupational pensions they have in general (with the two exceptions of the Czech Republic and Slovenia) embraced the so-called ‘new pension orthodoxy’ and introduced mandatory funded schemes, which invariably crowd out voluntary pension arrangements, be they individual or occupational.

As statistics regarding membership are difficult to obtain, we here refer to the data on asset funds provided by the European Federation for Retirement

7. Veterans are those countries with *multi-pillar* pension systems. In Denmark, Ireland the Netherlands and UK, the state has responsibility for basic entitlements with the aim of preventing poverty, while additional benefits are provided by supplementary occupational and/or individual schemes. By contrast, newcomers are those countries with *social insurance* pension systems. In newcomers (in Continental and southern Europe) the state provides the greater part of pension benefits through mandatory public schemes that are basically earnings-related.

Provision (EFRP)⁸ which, in 2007, conducted various surveys on the state of the market among its membership (EFRP, 2009). The EFRP distinguishes between different second-pillar schemes: i) mandatory schemes enshrined in national statutory law; and ii) voluntary arrangements, which are contracted at social partner or company level (both included in Table 1). At the end of 2007, mandatory schemes managed EUR 293.6 billion and voluntary ones EUR 4.302 trillion. By the end of 2008, the assets managed by the former had dropped to EUR 265 billion. EFRP member associations covered, in 2007, 83 million EU citizens.

Table 1 Private pension fund assets EU-27 (except Malta and Cyprus) as % of GDP

Year	2001	2002	2003	2004	2005	2006	2007	2008
Country								
Austria	2.9	3.8	4.1	4.4	4.8	4.9	4.8	4.4
Belgium	5.5	4.9	3.9	4.0	4.4	4.2	4.5	3.3
Bulgaria	0.6	1.0	1.5	2.1	2.7	3.2	4.1	3.5
Czech Republic	2.3	2.7	3.1	3.5	4.1	4.5	4.7	5.2
Estonia	0.0	0.2	0.9	1.9	—	—	4.6	—
Denmark	27.2	26.0	28.5	30.8	33.7	32.4	32.4	47.5
Finland	49.5	49.2	53.9	61.8	68.6	71.3	71.0	58.8
France	—	—	1.3	1.2	1.2	1.1	1.1	—
Germany	3.4	3.5	3.6	3.8	4.0	4.2	4.7	4.7
Greece	—	—	—	—	—	—	0.0	0.0
Hungary	3.9	4.5	5.2	6.8	8.5	9.7	10.9	9.6
Ireland	43.7	34.4	39.8	42.0	48.3	50.2	46.6	34.1
Italy	2.2	2.3	2.4	2.6	2.8	3.0	3.3	3.4
Latvia	0.2	0.5	0.7	1.0	1.3	1.6	—	—
Lithuania	—	—	—	—	—	—	—	—
Luxembourg	—	—	—	0.3	1.1	1.0	1.0	1.1
Netherlands	102.6	85.5	101.2	108.1	121.7	125.7	138.1	113.7
Poland	2.4	3.8	5.3	6.8	8.7	11.1	12.2	11.0
Portugal	11.5	11.5	11.8	10.5	12.7	13.6	13.7	12.2
Romania	—	—	—	—	—	—	0.0	0.2
Slovak Republic	0.0	0.0	0.0	—	0.6	2.8	4.2	—
Slovenia	—	—	0.5	1.7	2.4	3.0	3.0	3.1
Spain	5.8	5.7	6.2	6.6	7.2	7.5	7.5	7.1
Sweden	8.1	7.4	7.5	7.4	9.1	9.3	8.7	7.4
United Kingdom	72.0	58.8	64.4	67.6	78.6	83.4	78.9	—

Source: OECD.Stat

A closer look at the funds' portfolios would show that one of the most obvious outcomes of the 2008 financial crisis was a reallocation of assets from more to less risky. The countries with the highest exposure to equity (Ireland, the UK, the Netherlands – all within the Anglo-Dutch tradition) have experienced a significant shift towards bills and bonds, especially in defined-benefit plans, which saw their funding ratios plummet.

8. The European Federation for Retirement Provision (EFRP) is the largest sectoral association of pension funds and similar institutions for supplementary and occupational pension provision. The EFRP has 28 member associations in most EU Member States and other European countries that have a significant – in terms of size or importance – workplace pension system. The EFRP is registered in the EU Commission register of interest representation.

Even though the data for 2009 are not yet fully available, the worst effects of the financial meltdown are currently over, which is testified by recovering pension fund assets and funding ratios across OECD countries. There are, however, further adjustments to be implemented. The gradual but inexorable shift towards defined-contribution plans calls for reformed regulatory approaches, with some of the most pressing issues being multi-funds (declining risk allocation when people approach retirement), strengthened disclosure requirements and greater emphasis on financial literacy (OECD, 2009).

3.1 Old Member States

Table 1 clearly shows the aforementioned difference between private pension veterans and newcomers, as the assets held in private pension arrangements cluster extremely neatly at levels lower than 10% of GDP in the latter and anywhere between 34% and 114% of GDP in the former. In order to elucidate the distinctions, we briefly present the situation in two veterans (the United Kingdom and the Netherlands), as well as in two newcomers (Germany and Italy). The two veterans have been included on account of their highly diverse approaches to the degree of compulsion with which workers are occupationally insured. The newcomers, meanwhile, have been selected for two reasons. First of all, they show the need to set up occupational and supplementary pension provision at a time of severe cuts in public retirement benefits. Secondly, they also show (with respect to the newcomers in New Member States) that voluntaristic approaches may be only second best and that they may lead to problems of poverty alleviation in the near future.

Britain represents a paramount example in support of the view that private occupational pensions may not provide a solution to poverty in old age. Both the Basic State Pension and the State Second Pension (first-pillar components) provide meagre benefits that are progressively becoming flat-rate. In order to encourage occupational pensions, the state provides tax incentives. Coverage is selective (and insufficient) because occupational pension provision is not compulsory: in 2003, 71% of workers in small enterprises, 56% of employees in medium-sized firms and 40% of those employed in large businesses were not covered. Employers offer schemes that function as alternatives to the State Second Pension and must operate at or above government-set standards. However, generous defined-benefit plans are being slowly supplanted by stricter defined-contribution arrangements (Bridgen and Meyer, 2007).

The Netherlands is a virtuous case that testifies to the possibility of fulfilling the fundamental pension system targets of poverty alleviation and consumption smoothing through voluntary (or quasi-mandatory) occupational arrangements. The Dutch public pension system is a basic flat-rate benefit for all seniors based on residence. Due to broad corporatist arrangements, occupational pensions in the Netherlands expanded significantly in the 1980s and 1990s and by 2005 they covered some 91% of all workers in the country. In fact, when an employer in a sector concludes a pension contract with its employees, this is often extended by the Minister of Social Affairs to the whole sector, a

feature sometimes called ‘obliged voluntarism’. The state sets the regulatory framework for occupational schemes, which are then tailored to sector-specific conditions through negotiations between employers and trade unions (Bannink and de Vroom, 2007).

Among the newcomers, Germany had such a generous public retirement system that in 1999 coverage of occupational pensions was just 10% for women and 44% for men in Western Germany. Large enterprises with highly skilled employees were offering these schemes to retain workers and obtain tax exemptions through the so-called book-reserve schemes, which are held by the company and reinvested into it. The most covered sectors were public employment and the construction industry. Only defined-benefit schemes were permitted and these were tightly regulated and supervised by the state (as additional guarantee). The turn towards private retirement pension provision happened with the 2001 ‘Riester reform’, when employees were given the right to require the employer to transfer part of the payroll into occupational pension schemes, as deferred compensation, and vesting requirements were relaxed to bring more employees on board. In general, the coverage of occupational schemes increased by 10% in 2001-2004; however, coverage in the private sector (46%) and small and medium enterprises (up to 39%) was low. The current trend is towards expansion of defined contribution schemes and away from the book-reserve system. Unfortunately, patchy coverage, as in the UK, may be the ultimate outcome (Riedmüller and Willert, 2007).

The Italian public pension system was even more generous than the German one, until the 1995 ‘Dini reform’ introduced a ‘notional defined contribution’ formula that will link contributions much more strictly to benefits. This led to the need to stimulate occupational private pensions in order to preserve the consumption-smoothing element for most categories. In 1993 private pensions were regulated. Provision is split among closed collective funds, open funds and personal pension plans (PIPs). In addition, a 2005 reform tried to spur the private pension market in Italy by converting part of the *Trattamento di Fine Rapporto* (TFR) – a type of deferred wage – into contributions to open or personal pensions. As for occupational (closed collective) funds, the level of contributions is defined in collective agreements. Despite stronger tax incentives since 2005, enrolment has been low (12.8% of total employees). This is particularly problematic in Italy, which is dominated by small and medium enterprises. Trade union coverage is also low, thereby hindering the opportunities for greater occupational pension enrolment. Therefore, in the absence of adequate stimuli, an increasingly two-tiered labour market will probably be replicated in the pension system, thereby exposing Italy to the same patchy coverage suffered by the British labour force (Raitano, 2007).

3.2 New Member States

The countries of central, eastern and south-eastern Europe have chosen an approach to the expansion of private retirement provision that is in stark contrast to that observed in the Old Member States. This is in fact the region

that, second only to Latin America, most eagerly introduced mandatory funded pensions. Table 2 shows that eight out of ten post-socialist countries that entered the EU between 2004 and 2007 have implemented private funded arrangements (the sole exceptions being the Czech Republic, which has only voluntary schemes, and, to some extent, Slovenia, which introduced a funded scheme for public employees only). These pillars are still relatively small (with some variation); however, the overall contribution rates in these countries are too high to allow for a swift development of supplementary, voluntary schemes. The general trend is that only large enterprises offer occupational pension arrangements.

Table 2 The spread of mandatory funded schemes in New Member States

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia
Starting date	January 2002	No	July 2002	January 1998	July 2001
Contribution rate	5%	No	6%	8%	4% growing to 10% by 2010
Affiliation	Mandatory <42	No	Voluntary	Mandatory for new entrants Voluntary for others	Mandatory <30 Voluntary 30-50
	Lithuania	Poland	Romania	Slovakia	Slovenia
Starting date	January 2004	January 1999	June 2008	January 2005	January 2004
Contribution rate	5.5%	7.3%	2% growing to 6% by 2016	9%	Variable
Affiliation	Voluntary	Mandatory <30 Voluntary 30-50	Mandatory <35 Voluntary 36-45	Mandatory for new entrants	Only for public employees

Source: Holzmann, Fehér and Von Gersdorff (2008: 17).

There are three exceptions to this underdevelopment. In Slovenia, since 2004, all public employees have mandatory occupational pension plan coverage. This Closed Mutual Pension Fund for Civil Servants is a quasi-state fund (run by the state-owned *Kapitalska družba* holding) with around 180,000 members, i.e. roughly one quarter of the labour force. Another quarter is covered by other occupational arrangements. In Hungary, voluntary mutual benefit schemes cover some 1.3-1.4 million insured, that is, approximately a third of the labour force. The reason for the relative popularity of such schemes is that supplementary pension insurance was established as early as 1993 (five years before the mandatory counterparts) and it hence qualifies as one of the oldest forms of such insurance in the region. In the Czech Republic too, voluntary pension funds have been present since 1994. The ten licensed pension funds had in 2008 a total of 4.2 million members, which is an astounding 85% of those currently employed, thereby making the Czech Republic one of the countries with the highest supplementary pension coverage, alongside countries such as the Netherlands.

4. Pan-European pension funds

As explained in Section 1, the IORP Directive (2003/41/EC) of 3 June 2003 allows for the pan-European management of pensions and is part of a strategic framework to put in place the Financial Services Action Plan. The Directive establishes the fundamental freedom for authorised IORPs to provide cross-border services anywhere in the EU. It imposes two reciprocal obligations upon Member States: i) to allow undertakings located in their territories to sponsor authorised IORPs located in other Member States; ii) to allow IORPs authorised in their territories to accept sponsorship from undertakings located in other Member States. Finally, it prescribes an authorisation procedure for cross-border provision and lays down the rules for continuing supervision.

The advantages of setting up cross-border IORPs are substantial (Ernst & Young, 2009: 17; EFRP, 2003: 17-21). Pan-European pension funds enable greater efficiency and economies of scale as well as better governance and operational risk management. These benefits accrue to both financial service providers and to the social partners involved: the Member State, employees and employers.

The advantages enjoyed by employees with pan-European funds (especially in large multinational companies) include a single, consistent benefit structure that enables additional mobility. Due to economies of scale, employees also enjoy higher benefits or reduced costs. When firms offer a single benefit structure, the schemes' cross-country comparability is enhanced. Multinational companies with small, scattered workforces allow their employees to participate in large-scale operations, which guarantee professionalism and profitable asset management. Mobile workers avoid complex transfers and have a 'one-stop-shop' for their occupational pension arrangements. Being insured in one pan-European fund means dealing with a single payout institution.

Given all these advantages, it might have seemed natural to assume that the cross-border IORP market would mushroom. Yet this did not happen for, in actual fact, the IORP Directive does not solve all cross-border-related difficulties. On the positive side, the Directive introduces a system of mutual recognition based on minimum common rules regarding prudential matters, thereby enabling a single supervisory approach. Moreover, it sweeps away the need for multi-jurisdictional compliance as regards most financial service issues. On the negative side, it leaves the burden of conforming with national social and labour law as well as taxation requirements entirely on the shoulders of individual sponsors and pension providers (cf. Arnot, 2004: 64).

Hence, the hope that the IORP Directive and the accompanying Tax Communication (COM (2001) 214 final) would open up the way to a genuine internal market for occupational pensions was dashed (EFRP, 2003: 9-11). While practical steps have been taken to deal supranationally with taxation issues, social and labour law have remained firmly embedded in domestic policymaking. As a result, occupational pension funds in the EU do not yet display the characteristics of a single market; only the simplest cross-border

operations have so far developed and more advanced solutions are emerging only slowly, as the next section clearly shows.

4.1 The market for cross-border IORPs

CEIOPS (2008) indicates that in 2007 there were 48 IORPs operating on a cross-border basis, 39 of these having come into existence prior to the Directive's implementation (23 September 2005) and 9 at a later date. By June 2008, the sector had expanded significantly: there were 70 cases of cross-border activity in the European Economic Area (EEA), that is 46% more than only 18 months previously.⁹ Estimates for 2009 assess the number of cross-border IORPs to be more than 100. In 2008, the cross-border IORP market was divided among nine home and 21 host Member States. Among home Member States, the UK and Ireland had respectively 32 and 22 IORPs; Finland, Germany, Luxembourg, Austria, Belgium, Liechtenstein, and Portugal each had between 1 and 5 IORPs. The last four of these countries first set up IORPs after January 2007.

As for the number of cross-border operations conducted by individual IORPs, 56 operated in just one host Member State, six operated in two host Member States, five operated in three, two in four and one, based in Luxembourg, in as many as ten host Member States. Moreover, there are correlations between countries: 17 IORPs established in the UK operated schemes in Ireland and 21 Irish IORPs managed schemes in the UK. In other words, half of all cross-border operations occurred between these two countries. The next most favoured relation between Member States is represented by the seven IORPs established in the UK and operating in the Netherlands (two overlap with the previous category). Two factors explain the high concentration of provision: on the one hand, multinational companies (MNCs) set up cross-border operations where expatriates work and, on the other, most of these funds predate the IORP Directive and were established on the basis of bilateral agreements between pairs of countries.

CEIOPS' report is vague on the type of cross-border operations that these institutions perform – to the point of being overoptimistic about the successful implementation of the IORP Directive. A closer look at the market situation in Belgium¹⁰ reveals a dimmer picture; see Table 3.

9. As the Budapest Protocol makes clear, EEA states outside the EU are treated exactly as if they were Member States.

10. The Banking, Finance and Insurance Commission is one of the few regulators publishing a list of IORPs operating cross-border.

Table 3 Belgian IORPs operating cross-border

	Legal form	Location	Members
Groupaciel Pension Fund	Organization for Financing Pensions	Luxembourg	80
Nestlé (FPN) Pension Fund	Organization for Financing Pensions	The Netherlands	115
Pfizer Pension Fund	Organization for Financing Pensions	Luxembourg	10
Pfizer Provident Fund	Organization for Financing Pensions	Luxembourg	23
Ricoh Pension Fund	Mutual Insurance Association	Luxembourg	46
Total			274

Source : Banking, Finance and Insurance Commission (CBFA)

Of these five funds, only Nestlé has been established since the IORP Directive came into force. The others were based on bilateral agreements with Luxembourg. All, with the exception of Ricoh, changed their legal form and became Organizations for Financing Pensions.

It can be noted that the number of people insured is very limited and that hence, with the exception of a few funds in Ireland and the UK, the whole market for cross-border pension provision encompasses just a few thousand members. Moreover, it is impossible to assess the exact amount of collected assets, since separate information on foreign and domestic members is not available.

4.2 Current and prospective solutions

As the previous section made clear, there is still a very long way to travel along the road to an internal market for occupational pensions. In the wake of the elimination of most tax barriers, a relatively simple form of cross-border activity, i.e. asset pooling, took root. At the same time, however, employers, financial operators and the Commission itself perceive that the IORP Directive represents a real push towards establishing proper pan-European pension funds. Even so, insofar as the possibly unattainable harmonisation of social and labour law has placed the whole burden of compliance on individual providers or sponsors, development in this direction has been very slow.

Probably the simplest possible cross-border activity, asset pooling, is also the one that brings the most tangible monetary advantages. Ernst & Young (2009: 19) argues that it provides benefits of scale, tax efficiency, greater visibility and control over financial and other risks.

Yet asset pooling does not constitute a pan-European pension fund – not even in its more evolved form, where there is entity pooling, i.e. when the assets of the participating funds are aggregated in a separate legal entity, an asset-pooling vehicle. In fact, local entities have to be maintained in each host Member State and local trustees fulfil their fiduciary duties under domestic rules. The fact that liabilities are not yet pooled is a fundamental weakness of

this solution and one that also indicates that the IORP Directive was not really needed to create such an arrangement. Even so, its popularity is definitely on the rise.

Those Member States with the most advanced financial markets seized the opportunity to set up a number of tax-transparent vehicles to meet the demands for asset pooling. Just to mention a few, the most popular asset-pooling vehicles at EU level are the Common Contractual Fund (CCF) in Ireland, the *Fonds Commun de Placement* (FCP) in Luxembourg, the *Fonds voor Gemene Rekening* (FGR) in the Netherlands and the Pension Fund Pooling Vehicle (PFPV) in the UK.

In spite of the problems that non-harmonised social and labour law represent for sponsors and providers, there is growing interest in reaping advantages that go beyond asset pooling. If legislators in individual Member States responded rather swiftly and are (only slowly) being followed by providers, it is the sponsors that face the greatest uncertainty. There are in fact numerous operational, organizational and logistical dilemmas that have to be overcome and which this subsection will briefly investigate.

Regulators in Member States responded to the IORP Directive in quite varied fashion. Some home countries, e.g. Ireland and the United Kingdom, decided to rely on their reputation as veterans in the provision of occupational pensions. Others acted more swiftly and created dedicated pension vehicles: the Organisation for Financing Pensions (OFP) in Belgium, the *Société d'Épargne Pension à Capital Variable* (SEPCAV), the *Association d'Épargne Pension* (ASSEP) and pension funds regulated by the *Commissariat aux Assurances* (CAA) in Luxembourg. The Netherlands has several legislative proposals: the Premium Pension Institution (PPI), the Multi Pension Fund (multi-opf) and the All Pension Institute (API).

Even though providers only slowly responded to the Directive's potential, growing supply shows that dedicated vehicles are the way forward. In 2008, Mercer (9 October 2008) surveyed over 80 MNCs and 25 pension providers with EU operations for an overview of the attitudes to cross-border pension provision. Managers were disappointed by the limited variety of off-the-shelf products available for pan-European funds. This is partly due to lack of awareness. Mercer found out that six out of 25 providers already offered pan-European products consisting of investment, administration, communication and plan management. Of these, half use as their vehicle Belgium's Organisation for Financing Pensions (OFP), which is praised for its flexibility by market participants. Another 13 providers expect to have a pan-European product by 2011. Over half intend to offer more than one vehicle for their services.

As for sponsors, the problems are numerous. First, the process of setting up a pan-European pension fund is likely to take place on a step-by-step basis. Ernst & Young (2009: 18) argues that four distinct pension fund activities can be managed at the European level and then slowly merged into a pension fund proper. These are as follows: combining administrative functions; combining

asset management (asset pooling); sharing the risks of several pension funds populations (risk pooling – so also the liabilities are shared); centralising pension communication (to individuals and authorities).

Secondly, there are logistical problems involved in selecting the IORP's location. The most advanced financial markets in Europe (UK, Luxembourg, Switzerland, etc.) are the favourite candidates for being home Member States. As for host Member States there are considerations of coherence to be made, e.g. similarities between occupational pension schemes in central, eastern and south eastern Europe may represent an advantage for coordinated supervision.

Thirdly, there are two different business approaches to setting up a pan-European fund, namely the single- and multi-sponsor models (single corporate and multiple client models). The former is relatively straightforward: a single MNC establishes a pan-European pension plan to use its retirement schemes as a human resource management tool. The latter, instead, involves a single financial service provider, which sets up an IORP that attracts sponsors located in several Member States, thereby sharing in one legal entity their different pension plans. Hence, it is a sponsor's choice whether to establish its own IORP or hire an existing one for its pension plans.

5. Conclusion

All these EU actions seem to confirm the progressive integration of national welfare states and pensions within a more complex network of constraints and opportunities, in which supra-national institutions and players have a growing role to play. Such a trend is not pre-defined or automatic. National and European players interact and struggle to defend their own prerogatives: advances are followed by backlashes and vice versa. Nonetheless, the multi-tiered (or semi-sovereign) welfare state is slowly becoming a reality.

Yet the integration of occupational pension markets in Europe is far from having been fully implemented. EU Member States have witnessed a widespread increase in pension fund assets and in the number of people insured under collective and individual retirement plans. Occupational schemes fostered either voluntarily or via quasi-mandatory arrangements are on the rise in western Europe (among both veterans and newcomers). Central, eastern and south-eastern European countries, meanwhile, have chosen a different path towards the expansion of supplementary pensions. Mandatory, funded private schemes have been set up over the last two decades throughout the region, leaving little scope for the development of voluntary occupational funds.

At the supranational level, the spread of cross-border occupational funds has been prevented by a number of regulatory obstacles. While the IORP Directive 2003/41 has provided a framework for the set-up of cross-border services in order to reduce operational risks and inefficiencies, the expansion of these funds has proved both slow and difficult. Pension fund sponsors and providers continue to face operational, logistic and organisational dilemmas. In particular, the preservation of national competence on social and labour law and the burden on individual IORPs to conform with such a wide range of social, labour and tax rules have largely hindered the hoped for spread of pan-European pension plans.

Nonetheless, the road towards an integrated European pension fund market is not so very narrow. Different corporate approaches (single- versus multi-sponsor funds), opposing provision strategies (traditional versus dedicated pension vehicles) show the availability of numerous business options. It is not surprising therefore that, despite evident difficulties, the number of IORPs providing cross-border operations is steadily rising.

Finally, the financial crisis has perpetrated damage that goes beyond the negative rates of return. Whereas the worst consequences of the crisis are now, at the end of 2009, behind us, the damage inflicted on individual perceptions of the appropriateness of investing in private pension arrangements cannot be underestimated. Despite the outrage, there is probably no way back from private pension provision as a supplement to basic public coverage, but this has to be carefully managed. Stronger supervision, timely monitoring and reformed regulatory approaches are a necessary corollary to the gradual but

inexorable shift towards defined-contribution plans. In particular, the spread of multi-funds (whose portfolios have less risky profiles as people approach retirement), strengthened disclosure requirements, and greater emphasis on financial literacy, are some of the issues that need to be addressed in order to regain the trust of disillusioned private pension fund members.

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