15 November 2017

Mr Eoin Hartnett
Policy Advisor
Joint Committee on Finance, Public Expenditure and Reform and Taoiseach
Leinster House
Kildare Street
Dublin 2

Re: EU Commission Proposal (COM 2017/343) for a Regulation of the European Parliament and of the Council on a Pan-European Personal Pension Product

Dear Mr Hartnett

I refer to your letter of 9 October regarding the above, addressed to Governor Philip Lane, which has been passed to me for attention. I note that the Committee is particularly interested in the views of the Central Bank as to the practicalities of supervision and authorisation should this proposal be adopted.

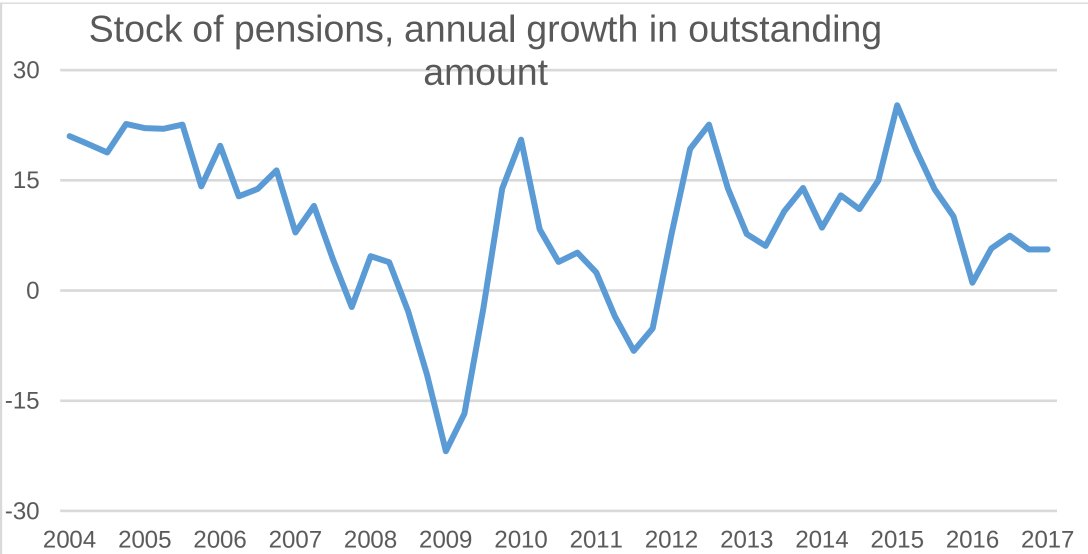
Background

The EU Commission's Proposal for a Regulation on Pan-European Personal Pension Product (PEPP) has two primary and complementary objectives - encouraging the take-up of personal pensions in the interest of the long-term sufficiency of retirement income and, in doing so, encouraging investment in a sustainable manner in the real economy over the long term, particularly in infrastructure projects and corporates. The proposed regulation is for a new pension product, to be offered alongside existing public and private pension products. It maintains that it will provide a new voluntary framework for saving operating on a level playing field across the EU with a strong consumer protection framework and sufficient flexibility around features such as national tax incentives, that PEPP holders can switch among PEPP providers and/or continue contributing to a PEPP while changing domicile from one Member State to another.

In principle, the PEPP Regulation has the capacity to improve choice, cost and availability of pension products for consumers. In particular, it could in time address the high degree of fragmentation between national markets and the limited degree of portability (for those consumers to whom this is relevant). These measures could also pave the way towards a deeper Capital Markets Union (CMU), which will bring benefits to the European economy and its citizens.

Pensions Savings in Ireland

The chart below shows the growth rate in the stock of private pension assets of households. As is evident, the growth rate is volatile, and indeed negative during some of the financial crisis years.[1]



Source: Eurostat.

In terms of public pensions, KPMG's Actuarial Review of the Social Insurance Fund (28 September 2017)[2], calculates that the net present value of gross pension liabilities over a 55 year period, considering only contributory State pensions, is €450billion. Netted against the PV of assets, the net liabilities are currently €161billion over this 55 year horizon. As noted, this is exclusive of non-contributory pensions.

[1] An international comparison of pension assets is confounded by a number of factors. In particular, the public pension provision varies across countries, and naturally has a large impact on incentives relating to pension saving. Tax treatment and expected cost of living expenses also vary across countries.
[2] http://www.welfare.ie/en/downloads/actrev311215.pdf

Moreover, Nivakoski and Barrett (2012) provide information on the proportion of total income which is derived from the state pension across categories of retirees and it is evident that the state pension provides a significant proportion of total income for the average retiree using data from the Irish Longitudinal Study on Ageing. For male retirees, the state pension (contributory and non-contributory) was found to account for 50 per cent of income, or €194 per week out of a total average income of €395 per week. For women, the proportion was higher, at 62 per cent. As would be expected, the state pension makes up a higher proportion of income for those with lower earnings. For men earning less than €250 per week, the state pension accounts for 90 per cent of earnings.

As regards pension coverage for existing employees beyond the state pension, Mosca and Barrett (2011), using the same database, showed that 20 per cent of male employees aged between 50 and 64 have no supplementary pension coverage while the figure for women is 41 per cent. These people would be reliant on the state pension when they retire but many of those who are covered may well have modest supplementary pensions and so the state pension will form a significant part of their retirement incomes.

From the above, it appears that the stated benefit of the regulation - to raise the take-up of personal pensions - were it successful, could be very beneficial for retired Irish citizens in the future. While a pan-European product – which transfers easily within the EU – will undoubtedly be beneficial for some, it is unlikely be a large benefit to those relying most on public pension entitlements. In particular, people in this situation are likely to be less internationally mobile than those on higher incomes.

Central Bank's Technical Observations

It is important that any initiative such as the PEPP proposal is designed to ensure that the best interests of the consumer are protected. This is especially important given the significance of pension products for the individual consumer who invests in them, and the relative complexity of a product such as a PEPP.

Before exploring some of the Central Bank's observations on the proposal, I would point out that issues relating to the regulation of Institutions for Occupation Retirement Provision (IORPs) and pension products together with the taxation of same are outside the remit of the Central Bank, being matters for the Irish Pensions Authority and the Revenue Commissioners respectively.

Regulatory Framework

A cornerstone of consumer protection, and financial services supervision more generally, is clarity on the respective roles and responsibilities of regulatory authorities both at EU and national level. The proposal provides that a PEPP may only be manufactured and distributed in the EU where is has been approved by EIOPA and that such an authorisation would be valid in all Member States. Certain regulated entities (e.g. credit institutions, insurance undertakings, IORPs, investment firms) may seek authorisation as a PEPP provider. The application process is outlined in the proposal and includes an obligation on EIOPA to consult and periodically update the competent authorities of the applicants. Ongoing supervision of compliance with the proposed PEPP Regulation would be carried out by the competent authority of the PEPP provider. Based on the definition in Article 2(17) and the detail of Article 5(1) these authorities are Member State prudential regulatory authorities under EU sectoral legislation. It should be noted that such regulators are responsible for assessing the stability and financial soundness of regulated entities and, depending on their other functions, do not necessarily currently have experience in supervising individual products.

There are a number of references in the proposal which imply there is to be only one competent authority per Member State. For example Article 54 requires that *"each Member State shall ensure that the competent authority has all supervisory and investigatory powers that are necessary…"* Depending on organisational arrangements there may need to be more than one such authority in any Member State. For example, in Ireland, the Pensions Authority regulates IORPs while the Central Bank regulates other potential PEPP providers.

In addition, the proposal also does not distinguish between consumer protection and prudential supervision. While in Ireland these functions are housed within the Central Bank the proposal should recognise that consumer protection functions may not reside with prudential responsibilities in all Member States. Given the need for strong consumer protection oversight the proposal should be clear on how this function fits within the overall framework.

As an EU institution, EIOPA is in principle well placed to approve an EU product subject to resources and expertise being available to it. However, PEPPs will have to comply with aspects of national legal requirements. For example Article 14 requires that *"PEPP* *providers shall ensure that within each individual PEPP account a new compartment could be opened, corresponding to the legal requirements and conditions for using incentives fixed at national level for the PEPP by the Member State to which the PEPP saves moves".* It is less clear how EIOPA in approving a PEPP can ensure that it is complying with the various national frameworks which will apply.

Chapter IX sets out, at a high level, arrangements for cooperation between competent authorities and EIOPA and includes a role for EIOPA in the settlement of disagreements between competent authorities in cross-border situations. However, it is not clear what powers EIOPA has in this regard.

Our view is that product oversight, prudential supervision and consumer protection supervision and the interaction/engagement between them should be clearly set out within the proposal, both at an EU and national level

Level Playing Field

One of the aims of the proposal is to "ensure a level playing field". While the proposal sets out "passporting" rules to facilitate providers entering Member State markets and seeks to standardise key features including product information, PEPP providers are regulated under different EU sectoral legislation. It is worth noting that these EU frameworks rules may impose different requirements on regulated entities (e.g. differences in capital requirements, limitations on the range of products that that can offered). This has the potential to create advantages in some sectors as compared to others in such areas as underlying costs and nuances of the products on offer (e.g. the inclusion of insurance cover).

In addition, given that taxation is a national competence the various tax treatments of pension products across the EU may result in PEPPs being a relatively more attractive product in one Member State compared to another. This latter issue is beyond the scope of the PEPP proposal.

Distribution

The proposal envisages the distribution of PEPPs either directly by PEPP providers or via PEPP distributors, such an insurance intermediaries. It also facilitates the use of on-line distribution channels by these firms. Article 25 outlines the consumer protection framework for the sale of PEPPs with associated advice, including explaining why a particular PEPP best suits the savers demands and needs and requires compliance with national consumer protection frameworks including, in an Irish context, the Central Bank's Consumer Protection Code.

However, Article 26 permits a consumer, subject to certain conditions, to waiver his/her right to receive advice in relation to a PEPP contract. In Ireland, there are only very limited circumstances where financial products can be sold without advice. The Markets in Financial Instruments Directive (MiFID) and the Insurance Distribution Directive (IDD) also place restrictions on execution only (i.e. non-advised) sales. Despite some proposed safeguards, including as assessment of the persons relevant knowledge and experience and warnings where relevant, it is difficult to see from a consumer protection perspective the merit in facilitating the purchase of such a complicated and long term product as a PEPP without the benefit of professional advice.

An online distribution model, facilitated by the Commission's proposal, may provide benefits to consumers, particularly in the area of cost savings and additional benefits may include effective comparison of different products where disclosure requirements regarding key features and risks of products are highly standardised. The use of an online distribution model should not prohibit the availability of advice to consumers. It should also be recognised that given the long term nature of a PEPP advice may be required by the PEPP saver at various stages of the PEPP lifecycle.

Key Information Document

The proposal will require the provision of a Key Information Document (KID) based on the KID required under the PRIIPs Regulation. The methodologies to be used in the PEPP KID, would need to be carefully considered to ensure that they are the best approach for this product and for PEPP consumers. In any event, it is worth noting that the development of the PRIIPs KID has been problematic and resource intensive at a European level with the resultant document itself scheduled for review by the Commission. This needs to be borne in mind in considering the PRIIPs KID as a starting point for a similar exercise.

The proposed PEPP Regulation is progressing through negotiations at Council working party level. The Central Bank is providing technical advice to the Department of Finance and will continue to monitor developments in this area. As you will be aware, the Commission's proposals may be subject to change based on EU Council negotiations and engagement with the European Parliament. The nuances of any such changes may influence our position on the matters flagged above.

Yours sincerely

Gerry Cross
Director Policy and Risk