The PEPP could become the new UCITS

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The EU is well on its way to agreeing on a new European financial product rule, the Pan-European Pension Product (PEPP). Proposed a year ago, both the Parliament and the Council have finalised their readings, ready to have it adopted before this Parliament steps down. The PEPP is intended to make large-scale portable and cost-efficient savings products available throughout the EU. Over time, this first buy-side financial initiative from the EU under the capital markets union programme could become a significant investment vehicle in support of the EU economy, even overtaking the current UCITS, first adopted in 1985.

The generally limited savings of European households for retirement alongside the high costs of investment funds, and even higher costs for life insurance products, underscore the need for a well-structured PEPP. Currently, European households are overweight in deposits, which may also be caused by the inefficiency of the investment fund markets. European fund markets, which function as a private savings vehicle for retirement (3rd pillar), are very fragmented with a low average size per fund, and high charges. A recent study for the Commission found that the average first-year cost for an investment product was 4%. ESMA found that performance charges reduce returns by up to one third, and countries with unbundling requirements, now part of MiFID II, clearly have lower costs.  

Against this background, a PEPP should encounter a huge demand and go a long way to tackle the inefficiencies in current investment fund markets. According to the Commission, with PEPPs receiving the same tax treatment as national products, the personal pension funds market could reach EUR 2.1 trillion by 2030. The Parliament reading (as well as that by the Council) has made the Commission proposal more attractive, by allowing for two default options (art. 39), guaranteed capital and life-cycle funds, and by reducing the requirement for providers to offer PEPPs in all member states. It has also set a maximum of 1% for the overall costs and fees of a basic PEPP. The Parliament has also added several provisions to improve the attractiveness of the PEPP, such as on the disclosure of product characteristics and investments, a redress procedure and portability. For example, consumers should be allowed to save simultaneously in several compartments of a PEPP. The cost of switching providers, even cross-border, should be limited to 0.5% of the balance (although it is not yet clear how a net position will be calculated).

On the default option, the Parliament’s reading leaves it up to the consumer whether a PEPP will be an insurance or fund product, but in the latter case, the consumer should be clearly informed about any additional risks that such PEPPs might entail (Art. 39.2). The PEPP as insurance product should be a life insurance product, and supervised as such. It stipulates that a maximum of 30% can be taken out in the first year of the decumulation phase, the remainder should be in the form of drawdown payments, annuities or a combination. Hence, in the case of a basic PEPP with a guaranteed capital, a minimum of 35% should be life-long annuities to do justice to the retirement nature of the product. (Art. 52.2). Even for the life-cycle backed basic PEPP, there is a proposal for drawdown payments.

The PEPP is thus well on the way to becoming an attractive EU-wide savings vehicle, provided the different funds achieve a minimum size. It is therefore essential that EIOPA maintains responsibility for authorisation of a PEPP, to allow it to monitor the number of providers with regard to market efficiency. In the Council reading, this element was taken away. Member states prefer to maintain authorisation and supervision at national level, which will run counter to the market integration envisaged for the product. EIOPA will also have a crucial role in maintaining a database of PEPPs, to facilitate the transferability between compartments, and the monitoring of their performance. Another crucial element for success is allowing for partnerships between providers so they can offer compartments, thereby improving the viability of the product. Where the PEPP provider does not offer a compartment in a given country, switching provider shall be free of charge. In the Commission proposal, a single company was obliged to offer a PEPP in all EU member states. PEPP providers should make decumulation options available that are coherent with the different tax incentives in member states.

The proposal as it stands now remains fairly concise. Implementing rules are brief. The Parliament has chosen to limit these to ‘level 2’ rules (i.e. standards on risk mitigation techniques for capital protection; the format, key characteristics of the PEPP key information
document (KID); and the decumulation phase) in order to maintain the attractiveness of the product. In this sense, it could become the ‘simple’ product we called for some 3 years ago.²

All in all, the PEPP could become an attractive and simple pan-European pension product. Critics will argue that the tax element is crucial if it is going to take off, meaning that contributions should be tax exempt, and that this will make or break the PEPP. A good design will steer some member states towards giving the product a favourable treatment. The first mover effect will follow.

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