13 OCTOBER 2004

PRESS STATEMENT

IORP DIRECTIVE

EFRP ISSUES LEGAL COMMENTARY ON THE PENSION FUNDS DIRECTIVE

Today the EFRP has published a Legal Commentary on the Pension Funds Directive.¹

The EFRP commissioned Simon ARNOT, a lawyer at law firm Steptoe & Johnson LLP in Brussels, to write the commentary. In the ’90s, he worked at the European Commission’s Internal Market Directorate during the crucial years of the inception of the Directive. This, together with his overall financial services expertise, means he is admirably placed to provide an independent review of the EFRP’s thinking on the Pension Funds Directive.

His Legal Commentary is the first comprehensive, article-by-article legal analysis of the Directive to be put in the public domain: it is freely available on request. The launch of the commentary is timed to coincide with run up for first meeting of Member State regulators to review progress of the implementation of the IORP Directive. This meeting, on 22 October 2004, is designed to address questions Member States may raise about the Directive.

1. ALL KEY ELEMENTS OF “EIORP 2005” REPORT VALIDATED

The legal commentary follows on from the EFRP’s “EIORP 2005” report ² but focuses on the Directive as a legal framework for all IORPs, domestic and cross-border. However, Simon ARNOT’s legal analysis confirms the EFRP’s approach on the main elements needed for the Directive to realize the prudential preconditions for the EIORP concept.

For the Directive to make EIORP 2005 a reality, and thereby clear the way for pan-European pension funds, the EFRP thinks that its cross-border provisions must :


- **be based on a single supervisor approach**
  The commentary argues that mutual recognition is matched by a **single supervisor approach**. This principle is firmly anchored in the Directive: each IORP - and EIORP - is in almost all situations only answerable to its own home State supervisory authority. If any host State prudential rules are imposed on non-domestic EIORPs, the primary enforcer is the EIORP’s own home State authority. The single EU licence also means that even where mutual recognition does not apply, such as any relevant national rules on social and labour law, these will be enforced in the first place by the home State supervisor.

- **minimize red tape when taking up cross-border activity**
  The commentary argues that “frontier formalities” faced by EIORPs may amount to no more than a check by the home State authority to see if it has any particular doubts. The burden of proof to show doubts lies with the home State authority and not with the EIORP. Attempts to turn the cross-border check into a full positive vetting procedure will infringe the Directive.

- **not introduce special home State rules for EIORPs**
  As a rule, any authorized IORP can become an EIORP without any special home State regime applying. The principal difference between EIORPs and domestic IORPs is that the Directive’s “full funding” standard, defined as possession of “**sufficient and appropriate assets**”, is applied to the cross-border operation without any opportunity for underfunding. This is the same standard – but applied more rigorously. Apart from this, all other standard home State rules apply.

- **respect the principle of pooled assets and liabilities**
  For any EIORP to realize its full potential, it must be able to put all assets for all its schemes, whether or not they relate to members in two or more Member States, into one fund. Without this, economies of scale will be impossible to achieve. The Commentary identifies this as a key objective of the Directive. The EFRP argued in its “EIORP Report” that EIORPs should be able to
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achieve multi-jurisdictional compliance without sacrificing the single pool of assets and liabilities and economies of scale.

2. CRITICAL AREAS IN IMPLEMENTATION FOR EIORPs

The Commentary also points out where care will be needed during implementation.

2.1. Ring-fencing

Simon ARNOT confirms that the ring-fencing issue is potentially problematic - especially if it were to break up funds. The EFRP’s analysis in its “EIORP 2005” report is confirmed: a wide range of legal techniques could be regarded as “ring-fencing”. The challenge is to select the right method for the particular job without breaking up the fund. The various occurrences of the concept in the Directive require a varied, context-sensitive approach.

Once this has been achieved, compliance with any host State rules applicable on a cross-border basis will be relatively easy. The commentary confirms that appropriate varieties of ring-fencing should enable multi-jurisdictional compliance whilst at the same time achieving economies of scale.

2.2. Reporting rules

The commentary identifies an unclear aspect of the reporting rules. Simon ARNOT argues that the Directive is unclear as to whether it demands scheme-by-scheme annual accounts and reports as a general rule or just in certain circumstances. However, the EFRP believes that as obscure as the Directive may be on this point, on balance it cannot be viewed as imposing a scheme-by-scheme reporting as a general rule.

This matter is particularly important given that the information rules for members are the only general exception in the financial services area to the mutual recognition principle and will any event require much cross-border coordination and goodwill between Member States.
2.3. Funding rules
The commentary establishes that the Directive’s full funding standard is possession of “sufficient and appropriate assets”. Although how this is to be defined remains an open question to be determined by each Member State, mutual recognition means that whatever national standard is finally decided upon in each Member State, it must then be accepted by other Member States without question. However, where a home State allows temporary underfunding the full funding standard still applies to the cross-border operations. This means that the techniques for distinguishing domestic from cross-border operations will need approaching with particular care.

2.4. CEIOPS role
Sensitivity will also be needed in putting in place the general cooperative framework between Member States to ensure that conditions emerge for unproblematic cross-border activity. CEIOPS will be set to play a major role as regards the Directive. But its mandate precludes it from “addressing” national social and labour law issues; it will have to confine itself to “communicating” national rules. This confirms EFRP concerns on possible problematic cross-border cooperation when it comes to compliance with relevant host State social and labour law.

2.5. Scope
How financial services providers other than IORPs in the sense of the Directive may use the Directive is not as yet clear. The Directive allows Member States to permit or require IORPs to “outsource” key management functions to other entities. Since there is no restriction on what these may be, it may be possible for many more financial services providers to benefit from this possibility than hitherto believed.

3. Why a legal commentary is useful now
The EFRP has long recognized the need to put forward an argued, comprehensive view of the Directive in advance of the implementation date of 23 September 2005. As yet, most Member States have moved slowly and in a piecemeal manner in

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3 Committee of European Insurance and Occupational Pensions Supervisors.
implementing the Directive. However, the pace of national and cross-border activity is starting to quicken:

- On 22 October there will be the first and perhaps only meeting of the “Transposition Group”: representatives of all Member States will meet Commission officials to discuss potential bottlenecks and problem areas.

- At the same time, but before clear views even at national level on the Directive have fully crystallized, the Working Group on Occupational Pensions, part of the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS), is working to ensure that the national systems fit together.

The need for a common analytic perspective is clear. At this stage a legal commentary may seem speculative as it can only describe the law as it might be rather than as it is. But the Member States themselves are in no better position to say what the law is. Since we are all in terra nova, we think that, at this stage at any rate, our Legal Commentary is the best guide to the directive available.

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**About the EFRP**

The European Federation for Retirement Provision represents the various national associations of pension funds and similar institutions for pension provision. The EFRP has members in most EU Member States. It will enlarge its membership in other new EU Member States as and when representative organisations for occupational pensions emerge.

EFRP membership at large consists of institutions for occupational (2nd pillar) retirement some of them also operating purely individual pension schemes. In some Member States up to 90-95% of the work force have their occupational pension funded through EFRP membership (e.g., Denmark, Netherlands, Poland, Sweden). Whereas in Germany, Spain, Ireland, the United Kingdom 80% of the occupational pension provision is funded by EFRP members.

Most EFRP members are non-profit making associations.

Members and beneficiaries are usually represented in their governance structures; many of them are managed on a paritarian basis between unions/employees and employers.

73 million EU citizens are covered for their occupational pension plan by EFRP Member Associations.

The EFRP’s aim is to provide Europe with a financing vehicle (pension fund or similar) – not precluding any others catered for by commercial undertakings – that is affordable for large sections of the population and that provides a degree of intra- and inter-generational solidarity. This is feasible if the conditions for investment and the proper prudential framework facilitate this type of collectively organised occupational pension provision.

Through its Member Associations the EFRP represents € 2.450 billion of assets (2002) managed for future occupational pension payments.

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4 EU Member States: Austria, Belgium, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Spain, Sweden, UK

Non-EU Member States: Croatia, Guernsey, Iceland, Norway, Switzerland
About Steptoe & Johnson

Steptoe & Johnson LLP has more than 400 lawyers in offices in Brussels, London, Washington, DC, Phoenix and Los Angeles.

Its EU practice, based in Brussels, provides expertise across the main regulatory fields governed by EU law, such as competition, trade, environment, free movement of goods and services, consumer protection and privacy as well as in a number of sectoral regulatory areas, including financial services (particularly banking, insurance and pensions), food, medical devices, biotechnology and cosmetics.