Pan-European umbrella vehicles for defined contribution plans

Occupational pensions are increasingly taking on a pan-European rather than purely national dimension, thanks to a combination of legislation in various fields and demographic developments. These changes are creating new opportunities for pension scheme operators, in respect of both multinationals and other organisations, and have the potential to create a single European pensions market.

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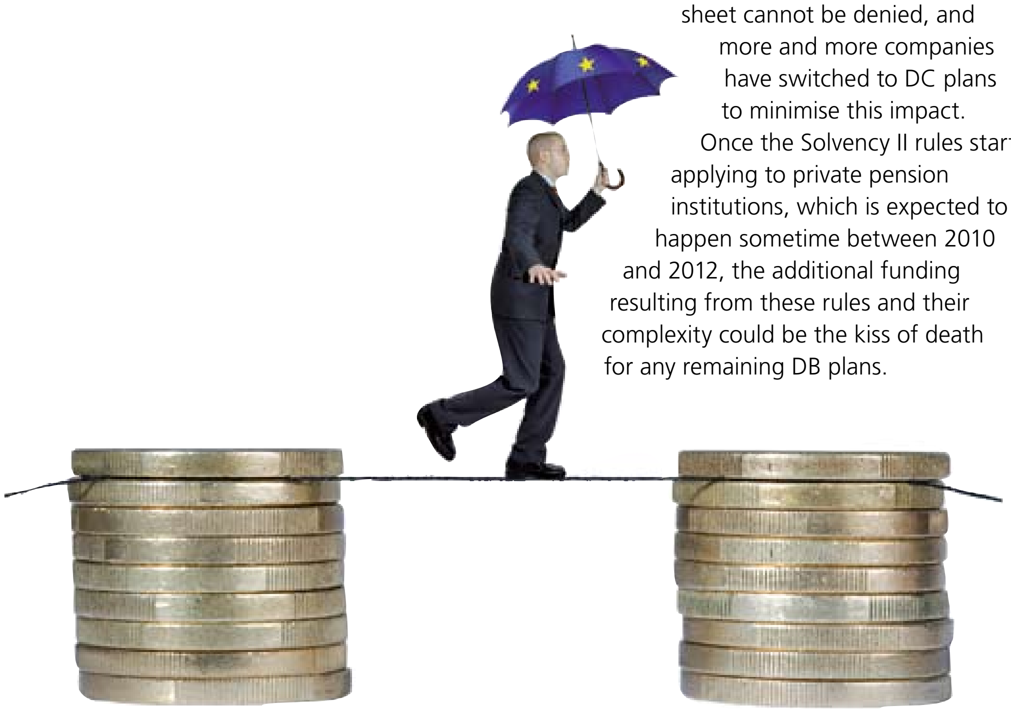
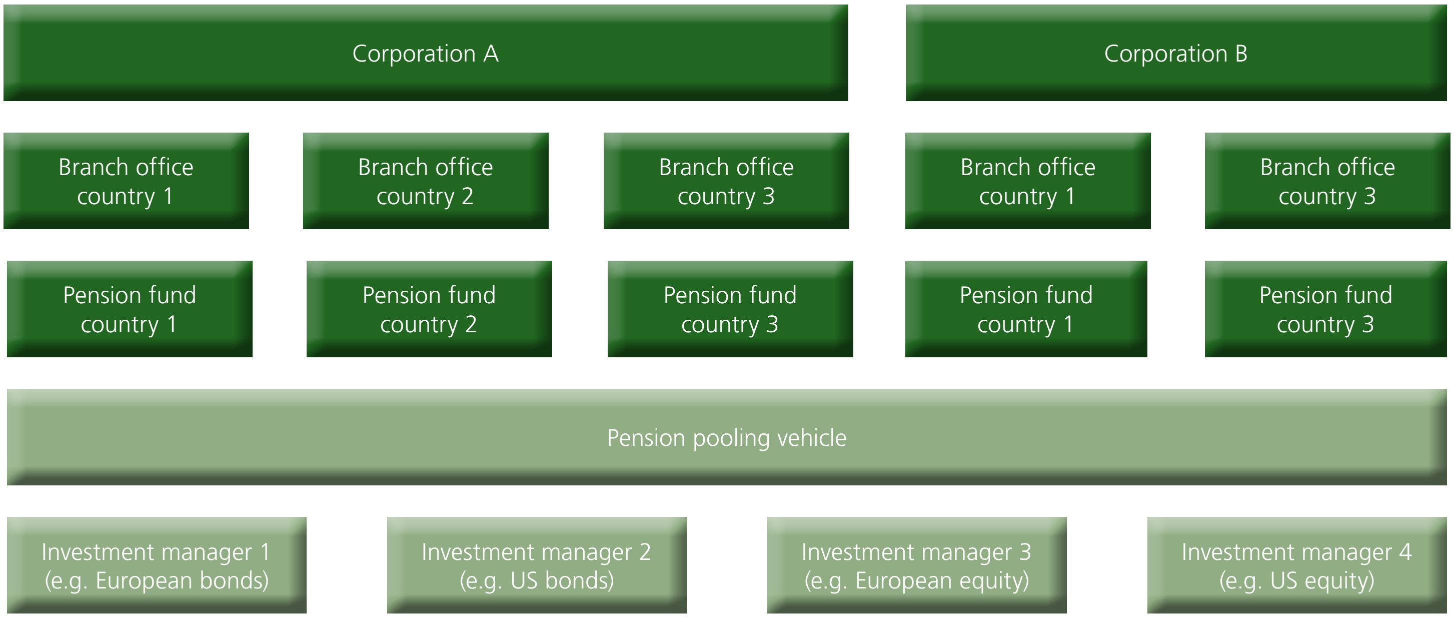
There are two important developments in the occupational pension landscape that we cannot ignore. First of all, the global trend of moving from defined benefit (DB) to defined contribution (DC) schemes. This shift has been prompted by international accounting standards and an ageing population. The impact that defined benefit obligations have on the balance sheet cannot be denied, and more and more companies have switched to DC plans to minimise this impact. Once the Solvency II rules start applying to private pension institutions, which is expected to happen sometime between 2010 and 2012, the additional funding resulting from these rules and their complexity could be the kiss of death for any remaining DB plans.



A second development is the formal implementation of the EU Directive on Institutions for Occupational Retirement Provisions (IORP). The IORP Directive will allow pension institutions to develop cross-border activities under the control of their home country supervisor and with mutual recognition in all other member states. Building on these developments, service providers now have major opportunities to set up umbrella vehicles to host pan-European DC schemes. Banks, asset managers, insurance companies and other stakeholders can create a single IORP in the form of an umbrella vehicle serving a multitude of client pension plans across different member states. These plans can cover a single corporation or a group of corporations.

Design of an umbrella DC plan

Joining an existing umbrella pension vehicle is an easy way for a corporation to achieve its pension objectives for all its European employees. The provider sets up a general framework that will apply to all the corporation's local branches. The outline of a common pension plan, including affiliation conditions, vesting principles, investment options, retirement age and so on, will be documented within this framework. In addition to the general framework, the provider will also need to define local sections for each country. The local section can extend the framework or indeed limit certain aspects of it. Each local section, for example, will define the contribution level for the specific country, taking into account local salary and HR policies. The local section may also deviate from the general framework to reflect local social and labour legislation. In the Belgian local section, for example, an employer may want to limit the investment options in order to comply with the minimum return applying to Belgian employees.



The advantages from a corporation's perspective are obvious. By joining an existing umbrella vehicle, a corporation can achieve its pension objectives without the costs associated with creating and maintaining one or more IORPs. A corporate sponsor can even join an existing umbrella vehicle for only a limited number of employees by restricting its applicability to senior executives or internationally mobile employees. Without the cost savings available through the existing umbrella vehicle, the corporate would be unlikely to set the vehicle up for a relatively small population. Centralising all the pension plans within the same vehicle will give corporations more control and insight. This, in turn, will actively help to achieve greater consistency in pension design across the different countries.

The fact that managing the plan will cost less than otherwise will be an important issue for local branches. As pan-European pension plans should respect local social and labour legislation (this aspect will be covered in the local sections), umbrella vehicles will be appropriate legal alternatives to offshore pensions. Indeed, under the European IORP Directive, companies can only contribute to pension schemes that respect local social and labour legislation. And as this aspect is often lacking in offshore pension plans, going offshore could be considered a breach of the European Directive.

The set-up will also benefit employees. Pooling the assets will give them access to a wider range of investment choices. The choices employees make may range from dynamic to conservative, thus allowing them to invest in line with the "life cycle" model. Younger employees would typically go for equity investments, while employees closer to retirement might typically look for a bond or cash portfolio.

Asset pooling will also reduce investment management fees, and this will result in better value for money. Employees taking up an international career will remain affiliated to the same pension plan. The general framework will continue to apply in such situations, although the individual employee may have to switch to a different local section. In most cases, the employee's current investment choices in the DC plan will remain applicable.

Pension pooling versus cross-border vehicles

There are two different ways to set up an umbrella pension vehicle serving a multitude of clients' pension plans across different member states:

- pension pooling vehicles;
- pan-European pension funds.

Within a pension pooling vehicle, existing local pension funds in different countries can 'pool' their assets into a single body. Instead of there being different investment managers, administrators and custodians in each country, the assets will be centrally managed in the pooling vehicle. The diagram above shows how a service provider can set up a pension pooling vehicle so as to achieve a pan-European solution. Such a framework could be ideal for corporations wanting to maintain their local pension funds.

The service provider can define a single pooling vehicle that can be used by existing pension funds of different corporations. The pooling vehicle will structure the investments through one or more investment managers.

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The above framework is not yet perfect as far as the concept of a transparent, one-stop solution is concerned, as each local corporate will still have to set up its own pension fund. It is a good solution, therefore, for larger companies that already have an existing network of pension funds. Ireland and Luxembourg are leading the pension pooling vehicles market. ➡

Ireland has its CCF (Common Contractual Fund), while Luxembourg has its FCP (Fonds Commun de Placement). Both vehicles are very similar: they are not distinct legal entities, and this offers the benefits of tax transparency. Within an FCP and CCP the investors have co-ownership of the assets. Since 2007 Belgium and the Netherlands have also been offering pension pooling solutions: the Institutionele ICB in the case of the former and the FGR (Fonds voor Gemene Regeling) in the case of the latter.

If a service provider is more interested in a one-stop solution for a DC plan umbrella, a true pan-European pension fund would be more effective. The provider can set up a single umbrella fund, which will then handle the design of the pension scheme and the administration of the management vehicle. The provider can also offer a range of investment funds or alternatively outsource this to various investment managers.

Luxembourg and Belgium are concentrating on offering solutions suited for hosting pan-European pension funds. The main vehicles in Luxembourg are the SEPCAV (Société d'épargne-pension à capital variable) and ASSEP (Association d'épargne-pension), while Belgium has created the OFP (Organization for Financing Pensions). A SEPCAV is a separate legal entity, where the beneficiaries are shareholders of the fund. This vehicle is only appropriate for hosting DC pension plans, and the benefit will typically be paid in the form of a lump sum. An ASSEP, on the other hand, is an association rather than a company, while the beneficiaries are creditors of the fund. An ASSEP can fund either DC or DB plans. An OFP is a separate legal entity that can host DC or DB plans.

Liechtenstein and Ireland have also created solutions for pan-European pension funds, but these have been less intensively marketed and are less widely known. In the Netherlands, competition to offer a pan-European vehicle, referred to as an API (Algemene Pensioeninstelling), is fierce, but no such vehicles have as yet been established.

Belgian's OFP structure

With the introduction of the OFP structure, Belgium has sought to promote itself as a prime location for pan-European pension funds. Potential service providers will find in the new OFP legislation a flexible governance framework that will help them set up an umbrella pension institution to host pan-European pension plans for different corporations and countries. An umbrella vehicle set up as an OFP can even host non-European plans. Besides a flexible governance framework, the OFP benefits from an attractive tax regime as, in practice, there are no corporate taxes applying to the vehicle. In addition, the OFP can derive benefits from the many double taxation treaties entered into by Belgium. Thanks to these treaties, relief or exemption from withholding taxes payable abroad will most likely be available. Lastly, an OFP can also benefit from VAT relief on most of the services provided to the vehicle. If, for example, the OFP outsources some or all of its administration to a different entity, these services will not be subject to VAT.

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By using the OFP structure, a service provider can set up an umbrella pension institution located in Belgium and supervised by the Belgian regulators. By merging different plans and schemes into a single umbrella structure, the provider can achieve significant economies of scale. The OFP has to be managed in Belgium, but it can outsource its activities to other local or foreign providers.

Within an OFP context, the general framework not only defines the outline of a common pension plan, but also the different investment opportunities. The provider can, for example, offer all participating corporations a choice of 20 investment funds. Local social and labour legislation may limit the portfolio of investment funds within the local section of a specific participating corporation, but such restrictions may also reflect the corporation's view on risk management.

Conclusions

A service provider wanting to use the opportunities offered by an umbrella vehicle still has some homework to do. First of all, the provider has to be able to manage pan-European schemes that are based on a general framework, but also respect local sections. Multi-lingualism is a key condition. Before such plans can be managed, the provider will first have to conduct a feasibility study to analyse the tax and other consequences of cross-border contributions, although most countries have in fact already changed their tax laws in response to European Court of Justice rulings such as Danner [2002]. The feasibility study will also need to draft a general framework for a DC plan and consider which aspects will need modifying in the local sections.

We are confident that, in the near future, several service providers will grasp this opportunity to offer umbrella pension vehicles that can host a multitude of corporations, plans, countries and investment compartments. Initially these vehicles may cover only a limited number of countries, but by building on market, demand it should in due course be possible to achieve a single European market for pension products. •