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The Future of Supplementary Pensions in Europe

FEFSI

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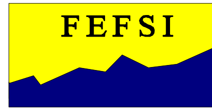
The Pensions Institute
Cass Business School
City University
106 Bunhill Row London
EC1Y 8TZ
UNITED KINGDOM

http://www.pensions-institute.org/



THE FUTURE OF SUPPLEMENTARY PENSIONS IN EUROPE

Proposal for the inclusion of rules on Defined Contribution Pension Funds (DCPF) in a Directive on Harmonisation of Occupational Supplementary Pensions (Pension Fund Directive)

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Executive Summary

The European Commission has taken the initiative on pension reform at EU level. Most recently it tabled on May 11, 1999 a Communication entitled “Towards a single market for supplementary pensions”[1]. FEFSI[2] very much welcomes the recommendations of the European Commission. FEFSI, in particular, welcomes the recognition of investment funds and companies as suitable pension vehicles by the Commission. FEFSI believes that traditional (i.e. defined benefit) pension institutions should be allowed to invest freely in UCITS and other regulated collective investment schemes and urges the Commission to take all necessary steps to ensure this freedom. The Commission has recognised the need to guarantee equal treatment between different occupational pension providers and stated the need to establish a genuine prudential framework for pension service providers which could involve the definition of similar rules for well defined products[3]. FEFSI argues that there is a need to define specific rules for supplementary defined contribution (“DC”) systems on EU level. Because DC systems may take various forms ranging from single funds to self-directed pension savings plans with a wide range of investment options, FEFSI believes that a European pension fund directive should not prescribe a specific DC system. Instead FEFSI believes that the envisaged directive needs to address in general qualitative terms the following key areas with respect to DC pension funds (“DCPF”):

- **Criteria relating to the institutional security of a DCPF** (approval of pension fund by a competent authority with intervention powers, management by asset managers and agents approved in the EU which fulfil strict criteria covering responsibility, competence, and the managers’ standing), criteria with respect to the structure of DCPF (custody of assets with a depository, separation of powers between management and depository, prudential investment, risk diversification of assets, world-wide investments, limits on pledging or assigning assets)

- **Criteria relating to the economic efficiency and security of a DCPF** (possibility to focus investments on equity and real estate, risk diversification, roll-up of gains, long-term accumulation of the contributions paid for pension provision)

- **Criteria relating to the transparency of a DCPF** (regular reporting to the supervisory authority and beneficiaries, audited yearly accounts)

- **Criteria relating to the flexibility of a DCPF** (flexibility of payment of contributions and during the pay out/ withdrawal phase)

- **Criteria relating to the portability of a DCPF** (right of unlimited transferability (or ownership) of plan assets at market value for the beneficiary without a loss of retirement income, no waiting periods, market value driven valuation to be carried out based on rules established by the competent authorities).

[1] COM (99) 134.

[2] FEFSI is the European Federation of Investment Funds and Companies which represents the investment funds industry of the 15 EU member states, the Czech Republic, Hungary, Norway, Poland and Switzerland. Through national associations, the Federation represents about 850 management companies and over 20,000 publicly offered open-ended securities funds with 2.5 trillion Euro in investment assets.

[3] COM (99) 134, p.4.

Preface

The Future of European Supplementary Pensions

Retirement provision is one of the greatest political and economic challenges of our times. Not only in Europe, but world-wide, governments are facing the situation that state pension schemes cannot be sustained in their present form.

The European Commission has taken the initiative on pension reform at EU level. Most recently it tabled on May 11, 1999 a Communication entitled "Towards a single market for supplementary pensions"[4]. FEFSI very much welcomes the recommendations of the European Commission of 11 May 1999. FEFSI welcomes the recognition of investment funds and companies as suitable pension vehicles by the Commission. FEFSI believes that such traditional pension institutions should be allowed to invest freely in UCITS and other regulated collective investment schemes and urges the Commission to take all necessary steps to ensure this freedom.

From FEFSI's point of view, the Communication, however, is more based on an assessment of the interests of the traditional pension providers than on the interests of enterprises and workers in Europe, especially of small and medium sized businesses. It consequently may fail to reach a large part of future pension beneficiaries. FEFSI is concerned that in the past the traditional instruments in the field of voluntary second pillar pensions have not been able to reach out to small and medium-sized enterprises. This is particularly relevant as SMEs employ the largest workforce within the Union. Especially smaller enterprises are often deterred by the administrative and other costs as well as the liability risks associated with the traditional instruments.

The Commission has recognised the need to guarantee equal treatment between different occupational pension providers and stated the need to establish a genuine prudential framework for pension service providers which could involve the definition of similar rules for well defined products[5].

FEFSI argues that there is a need to define such specific rules for supplementary defined contribution ("DC") systems. Under such systems employers only commit themselves to regular contributions of a certain level towards their employees' pension provision while the more traditional defined benefit systems (DB) which exist throughout Europe usually require employers to cover also certain biometric risks of their employees such as longevity, disability and survivors' pensions[6]. DC systems are especially suited to reach medium sized enterprises and the pension

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[4] COM (99) 134.

[5] COM (99) 134, p.4.

[6] DB systems often provide for minimum guarantees which require an investment policy that focuses on investment in fixed interest instruments instead on higher yielding e.g. equities. **FEFSI believes that in the field of pension provision, risk does not mean the lack of guarantees, such as the lack of a guaranteed minimum return. In FEFSI's opinion pension risk means the failure to achieve the potential maximum retirement income without taking undue risks.** In a pension system which is invested in so-called "risk-free" treasury bonds this risk is substantially higher than in a system based on investment in real assets such as equities. As the findings of the Commission suggest, with an investment in equities, with a very high degree of probability, you can end up with a pension that is at least four and a half times larger and possibly up to six and a half times larger than an investment in bonds. While equity risk is high in the short term, it is not high over the long-term investment horizon typical for pension savings; on the contrary, bonds have low risk in the short term but have high long-term risk (cf. David Blake: "Is the German pension fund system a model for Europe?", speech delivered on 11 November 1997 before members of the German parliament).

needs of a mobile workforce, as demonstrated by US experience. The most important defined contribution system, the "401(k)-plan", is the fastest growing vehicle for occupational pension schemes. The number of active members of these 401(k)-plans rose by 350 per cent since 1984 while remaining nearly constant in other pension plans[7].

Because DC systems may take various forms ranging from single funds to self-directed pension savings plans with a wide range of investment options[8], we believe that a European pension fund directive should not prescribe a specific DC system. Instead FEFSI believes that the envisaged directive needs to address in general terms the following key areas with respect to DC systems:

- **institutional security**
- **economic efficiency and security**
- **transparency**
- **flexibility**
- **portability**

These criteria are based on the goal of funded pensions to provide for an adequate level of retirement income with the least effort while maintaining a high level of security. FEFSI proposes to specify certain quality criteria with respect to each area in the proposed directive which a DC system would need to fulfil in order to qualify as a recognised second pillar pension scheme under European law (hereinafter: "Defined Contribution Pension Fund" or "DCPF"). These quality criteria aim at enabling DCPF to meet the goal of optimal pension provision. This approach would satisfy the Commission's aim to arrive at a minimum harmonisation of supplementary pensions and at the same time respect the principle of subsidiarity by not prescribing specific types of instruments to member states allowing them to maintain their existing pension schemes.

The regulation of tax treatment of DC systems could be left to the individual members states according to the split of jurisdiction between the EU Commission and the member states. However, a policy decision at EU level on Europe-wide principles of taxation for these funds would be very helpful.

FEFSI tables hereinafter a "Proposal for the inclusion of rules on Defined Contribution Pension Funds (DCPF) in a Directive on Harmonisation of Occupational Supplementary Pensions" (Pension Fund Directive). The proposal contains a description and the reasons for the different criteria necessary to achieve a harmonisation of defined contribution schemes on EU level.

FEFSI believes that if a harmonisation of defined contribution schemes on EU level can be achieved there will be a bright future for European supplementary pensions. Europe will obtain a particularly modern and efficient second pillar system.

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[7] EBRI

[8] Cf. FEFSI Report on use of mutual funds for retirement purposes, Brussels 1999.

Proposal for the inclusion of rules on Defined Contribution Pension Funds in a Directive on Harmonisation of Occupational Supplementary Pensions (Pension Fund Directive)

I. Introduction: The current situation of European occupational pensions

The reasons for the necessity to introduce harmonised rules for DC systems in Europe become clear when looking at the current state of occupational pension systems in Europe and their weaknesses.

Europe's occupational pension schemes show a very diverse picture. Common to all systems is the dependency of pension benefits on an employment contract or the pursuit of a particular profession. In the majority of cases the contributions are at least in part paid by the employer on a voluntary basis. Although in some cases (e.g. France) occupational schemes are also run as pay-as-you-go systems, almost all occupational pension schemes are funded. In other words, contributions paid into these schemes are invested for the purpose of funding future benefits rather than current pensions payments.

As funded systems, occupational pension schemes are less vulnerable to demographic changes and are therefore in principle eligible to relieve the state pension systems. However, with respect to their specific design many of the existing occupational pension instruments suffer from a range of shortcomings which considerably hamper their wider coverage and lower their benefits:

- In Europe the coverage of occupational defined benefit pension schemes among the working population varies between 5 and 90 per cent.

- Many of the schemes are either tied to a specific employer or a specific industry, and as a result a multitude of schemes exists. **This hampers the realisation of the EU goal of mobility of workers both within their countries and at the European level because the transfer of vested pension rights when people change their jobs is either not possible at all or involves a considerable loss**.

- The widely spread defined benefit systems (where the employer guarantees the employee a certain level of benefits and also covers his biometric risks) lead to unpredictable liabilities for the employers. In particular small and medium-sized companies often are not in a position to expose themselves to such risks without jeopardising their own existence. This is particularly alarming considering that SMEs represent the largest employer in Europe.

- The management of pension monies is often subject to restrictive investment laws and regulations which require fund managers to invest predominantly in bonds or in the national market. This makes it impossible for the schemes to achieve their goal of earning an adequate pension income for their contributors and thus lowers their attractiveness.

- The taxation of occupational pension schemes varies greatly within Europe. Whilst in most countries pensions are subject to deferred taxation (which means that the pension benefits become liable only during the pay-out phase) there are also various systems with an up-front taxation (i.e. contributions are paid from taxed income). Up-front taxation lowers the attractiveness of occupational pension schemes, both for employers and for employees.

Therefore, only in a few countries have the existing occupational pension systems been able to substantially relieve the state pension systems.

This brief analysis of the various pension systems in Europe indicates that each country has developed its own system in line with its political, economic and social conditions. In fact, there is hardly a political field which is the object of such fierce political struggles as the population's retirement system. This is also the reason why each country has developed its own pension fund system or is in the process of doing so. Against this backdrop it becomes clear why the EU Commission has not yet been able to devise a single European pension fund system. On the other hand there are increasing demands from industry and business to introduce a single European pension fund system to keep pace with Europe's integration process and an increasingly mobile workforce. As a means of overcoming the current problems in the field of occupational retirement provision in Europe, FEFSI proposes that only DC systems that fulfil certain general quality criteria are recognised as supplementary occupational retirement schemes on European level.

FEFSI believes that the following key quality criteria to reach this aim are:

- **Criteria relating to the institutional security of a DCPF** (approval of pension fund by a competent authority with intervention powers, management by asset managers and agents approved in the EU which fulfil strict criteria covering responsibility, competence, and the managers standing, criteria with respect to the DCPF - custody of assets with a depository, separation of powers between management and depository, prudential investment, risk diversification of assets, world-wide investments, limits on pledging or assigning assets -). Most of these are addressed by the “fundamental prudential rules” envisaged by the EU Commission.

- **Criteria relating to the economic efficiency and security of a DCPF** (possibility to focus investments on equity and real estate, risk diversification, roll-up of gains, long-term accumulation of the contributions paid for pension provision).

- **Criteria relating to the transparency of a DCPF** (regular reporting to the supervisory authority and beneficiaries, audited yearly accounts).

- **Criteria relating to the flexibility of a DCPF** (flexibility of payment of contributions and during the pay out/ withdrawal phase).

- **Criteria relating to the portability of a DCPF** (right of unlimited transferability (or ownership) of plan assets at market value for the beneficiary without a loss of

retirement income, no waiting periods, market value driven valuation to be carried out based on rules established by the competent authorities).

II. Criteria for a defined contribution pension fund (DCPF) system

In order to facilitate the discussion, the proposed quality criteria for DCPF are tabled in the order that appears in the EU Commission Communication dd. 11. May 1999.

A. Prudential rules for pension funds

The ideas of the Commission relate primarily to the key aspects of institutional safety and transparency of a DCPF. The Commission addresses the following points:

1. Separation of assets / neutrality from employer

The Commission proposes to separate the assets of the pension fund and of the sponsoring employer[9]. FEFSI strongly supports this proposal. A pension fund system should never be tied to an employer, in other words, the assets of the pension fund should be separated from those of the employer. An occupational pension system which is tied to an employer involves a number of potential conflicts of interest between employees and company or between early retirees and late retirees. In principle pension provision is nothing more than a long-term savings plan which serves the purpose of building up a capital stock which may buy a pension in retirement. Nobody would seriously consider entrusting his life-long savings to his employer. Why should employees want to entrust the management of the capital saved in connection with the second pillar system to the employer? There is no objective reason why they should do that.

2. Authorisation of pension funds by a competent authority & the definition of the supervisory authority's power to intervene and setting up of a system of sanctions.

The Commission proposes to require the authorisation of pension funds by a competent authority with well defined intervention powers as well as the setting up of a system of sanctions[10].

In order to make it impossible for third parties to access the pension capital, FEFSI thinks it is necessary to provide for a legal framework which involves state supervision. This legal framework should specifically provide that the assets must be managed solely in the interest of the investor's pension provision. The authority would necessarily also need the power to police the sector, i.e. to set up and implement a system of sanctions, including but not limited to a revocation of authorisation.

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[9] COM (99) 134 para. 29.
[10] COM (99) 134 para. 29, box 6.

3. Authorisation subject to strict criteria regarding the responsibility, competence and integrity of managers.

The Commission proposes to require authorisation of pension funds subject to strict criteria regarding the responsibility, competence and integrity of managers[11]. FEFSI thinks it is necessary to provide for a legal framework which involves a check of the quality of the managers similar to article 4 (3) of the UCITS directive (85/611/EEC).

4. Setting up a mechanism for periodic statements to members

The direct connection between contributions and accumulation of assets for pension provision should be clear and transparent for the investor. The Commission proposes a mechanism of periodic statements to members12. FEFSI fully agrees with this approach and suggests to require DCPF to publish regularly the net asset value of the beneficiaries' pension assets, a prospectus as well as half-yearly and audited annual financial reports. These requirements should be modelled on the time tested articles 27 to 35 of the UCITS directive. Furthermore, the participants should receive annually a pension status report. The total of information provided to the prospective pensioner will cover at least: the total employer and employee contributions, the investments made by the fund, the income earned by these investments, the value of the accumulated pension assets, as well as the fees and commissions paid within the scheme and possibly the performance of the DCPF as it relates to the envisaged results. A basis of information for DCPF participants similar in principle to that provided by UCITS will ensure a high level of transparency as required by the Commission especially in case of DC systems. Members of a pension scheme will be provided with substantial regular information similar to the shareholders of a company who receive information about the company whose equities they own.

The Commission proposes in this context an audit for the annual reports of the pension fund. The audit should also examine whether the DCPF is managed in conformity with the regulations of the pension law and whether the DCPF rules and terms of contract have been complied with. The result of the audit is to be published in the annual report which should include the full wording of the audit certificate.

5. Setting up a mechanism for periodic statements to the supervisory authorities

The Commission proposes a mechanism of periodic statements also to supervisors[13]. FEFSI fully agrees with this approach and suggests to require DCPF to send the prospectus, amendments thereto, half-yearly and audited annual financial reports to the pension regulator. These requirements are modelled on article 32 of the UCITS directive. Additionally, the pension regulator should be able to request from the DCPF at all times all information it sees fit to avoid any fraud, misuse or embezzlement of pension funds assets. These should be supplemented at regular intervals by an explanation of the overall investment strategy in the light of the commitments entered into. A good basis of information similar to that provided

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[11] COM (99) 134 para. 29.
[12] COM (99) 134 para. 29.
[13] COM (99) 134 para. 29.

by UCITS will ensure a high level of transparency and security as required by the Commission, especially in case of DC systems.

6. Further requirements with respect to the structure of a DCPF

FEFSI regards the following criteria which are not expressly mentioned in the Communication as essential ingredients of a high quality DCPF:

a) Segmentation of functions with regular internal checks

The Commission suggests in the context of discussion of adequate supervision of pension funds using the prudent man approach to management that a segmentation of front-end and back office with regular internal checks is necessary[14]. FEFSI proposes to recognise that within a DCPF there are several functions to be carried out, including but not limited to the following:

- Investment Management
- Fund Accounting
- Depositary / Custody
- Pension Administration Management
- Distribution/Marketing

FEFSI proposes to allow any approved DCPF manager to carry out investment management, fund accounting, pension administration (contributions, benefits collection and payments, other registrar communications), management and distribution/ marketing functions. However, a DCPF provider providing more than one of the above mentioned functions must strictly separate the function of investment management from fund accounting (“Chinese walls”). The depositary /custody function may never be carried out by the DCPF manager. Furthermore, the custodian (depositary) should be given certain control functions as outlined in Articles 7 to 11 of the UCITS directive. This arrangement has worked well for the UCITS industry and will considerably strengthen the institutional safety of a pension fund. This has the following implications:

The assets of the DCPF must be safe-kept separate from the DCPF manager by a credit institution which is legally independent of the DCPF and licensed to act as a depositary (depositary principle). The involvement of the depositary makes it impossible for the DCPF management company to access the DCPF’s assets. Another important function of the depositary could be to determine the net asset value of the DCPF. Correct pricing ensures that the investor's share of the DCPF assets is properly calculated. The DCPFs institutional security is additionally enhanced by the fact that the depositary performs a number of legally regulated controls and participatory powers. In certain circumstances, the depositary also represents the interests of the investors by asserting claims or by bringing action against endangering the DCPF assets. In performing its functions the depositary must act independently of the DCPF management company and solely in the interests of the beneficiaries. It may carry out the instructions of the pension fund management only if these are not in breach of any law or the rules of the DCPF.

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[14] COM (99) 134, box 6.

FEFSI believes that the goal of retirement provision furthermore makes it necessary to discuss appropriate capital requirements for the depositary of a DCPF system.

The Commission has proposed that pension funds should have adequate internal controls which are verified by external auditors[15]. FEFSI believes that the internal audit function at the level of the DCPF system is very important. The purpose of the internal audit function at the management of a DCPF is to provide the management with information about the orderly conduct of business in all departments and units as well as about any shortcomings and hazards identified. The supervisory authority must specify the requirements concerning the structure, organisation and equipment of the internal audit function in order to ensure that there is an ongoing and effective control of business operations. Each audit should lead to a report which is used by the management to devise counter-measures if any exceptions have been detected. FEFSI supports the Commission view that internal controls are checked by external auditors.

b) Capital

FEFSI believes that the capitalisation of the management entity of the DCPF is not an issue if the depositary of a pension fund is adequately capitalised to compensate the fund for losses incurred.

c) Portability of the Pension

FEFSI suggests that contributors should receive fund units for their contributions. Employees wishing to switch from one DCPF arrangement to another should have the possibility to do so by “selling” the units of their system and “buying” units of another. This solves the problem of transfer value: purchase and sale should be effected on the basis of rule driven valuation systems based on market values. This feature of an ideal pension is becoming increasingly important in view of the fact that people will change their jobs much more frequently than in the past. For instance in the United Kingdom employees on average change their jobs every 6.4 years. At the same time the number of part-time workers is increasing, especially among the female population. If an employee's share of a pension fund is portable, adequate pension income can be achieved even in an environment of high mobility. This would also reduce impediments to the free movement of workers, one of the fundamental freedoms embodied in the EU Treaty.

aa) Ownership Status of Employees

FEFSI favours a DCPF system based on securities ownership. This strengthens the position of the individual employee: he/she has not just claims on a pension scheme but indeed has an ownership title to the assets destined for retirement provision. This will facilitate transferability and portability of pensions. Also there is no need for specific solvency rules for DCPF.

bb) No Waiting Periods

[15] COM (99) 134, box 6.

A DCPF system that is based on ownership of securities has the additional advantage that it does not need any waiting periods for pension entitlements. This means that all employees can be included in the system from the first day of their employment (including part-time and short-time workers). This would also reduce impediments to the free movement of workers, one of the fundamental freedoms embodied in the EU Treaty.

cc) Neutrality

FEFSI strongly believes that switching of jobs should not be an acceptable argument to reduce the transfer value of a pension in favour of the employees who remain in the fund. This, however, is the case in a number of member states with traditional pension instruments. DCPF are ideally suited to maintain neutrality in case of job change as they are based on ownership of securities or otherwise secure the transferability of the individual's pension assets at market value.

d) No Pledge or Assignment

The Commission did not discuss the need to protect the assets of a pension fund against pledge or assignment. The management of a pension fund should not be allowed to pledge or assign assets of the fund or make guarantees running against the fund in order to avoid any losses to members, other than for the purpose of efficient portfolio management (as defined in Article 21 of the UCITS directive).

e) Freedom of Choice

FEFSI believes that the directive furthermore should not prohibit any employee to have the right to choose a DCPF and/or DCPF management companies and/or DCPF investments on his/her own judgement. In the same way as savers can deposit their savings with several competing institutions, employees should be free to invest the contributions for their occupational pension scheme with several DCPF or have at least several investment options inside their DCPF. Depending on his/her personal risk attitude or age, the investor should be free to choose between high-risk or low-risk strategies or a combination of both. During their working life, employees should not be tied to a particular pension institution.

f) Flexibility

FEFSI proposes that payment streams into/out of a DCPF should not be tied by a rigid formula. Instead, each employee should be free to fix his own contribution/withdrawals rate and his own payments into/out of the system, even if they no longer enjoy a tax privilege beyond a certain level. It should be possible for the employee to increase, reduce and temporarily suspend the agreed regular payments/withdrawals. In this context also ways of achieving more flexibility of employers contributions need to be discussed.

B Investment Rules

1. Prudent Man Rule/Quantitative Investment Limits

A regulation of investment rules not only relates to the institutional safety of a pension fund but more importantly is predetermining to a large extent the economic efficiency of the fund. The legal framework should specifically make sure that the assets are managed solely in the interest of the investor's pension provision. For instance, the law should make it absolutely clear that these funds may not be used for speculative purposes, e.g. by constraining borrowing powers.

Scientific research and the findings of the Commission suggest that pension funds should pursue an investment policy which achieves a high long-term performance similar to the very successful Anglo-American pension funds which invest a large portion of their assets in equities and – to a much lesser degree – in real estate.

The Commission favours a qualitative regulation of investment rules based primarily on the so called “prudent man approach” and only if a Member State so wishes, national authorities might be allowed to apply quantitative limits provided they do not unduly restrict freedom of investment[16]. FEFSI fully supports this approach.

2. Risk Diversification

The Commission suggests in its discussion of asset liability management (ALM) techniques, that ALM will consider portfolio diversification as a part of risk diversification[17]. In order to ensure a level playing field among all pension institutions - whether they use ALM techniques or not - there should be an express requirement for DC systems to follow the principle of “risk diversification”. As suggested by the Commission, in case of DCPF, Member States may limit investments in a single issuer/investment and in the sponsoring company to a prudent level (e.g. 5-10%). FEFSI believes that Member States should also limit speculation, e.g. limit the use of derivative instruments in DCPF to efficient portfolio management purposes, as it is foreseen in the UCITS Directive.

3. Investment Policy Focus on Equities and Real Estate

FEFSI recognizes that, in order to overcome the bond oriented investment policy, especially of traditional pension providers in Continental Europe, it may not be sufficient to just change their investment rules. Therefore, FEFSI accepts that, in addition to the prudent man rule, Member States may wish to have the option to set investment rules that assure that the DCPF pursues an investment policy which is sufficiently based on investment in equity and real estate. EU Member States such as Austria, Belgium and Germany have implemented specific limits for an investment policy of DCPF in a way to allow them to meet the goal of funded pensions based on minimum investment in equity and/or real estate. These rules especially help younger contributors to invest appropriately.

Such limits will need to be set with care and with carefully judged flexibility, both in the case of a DCPF and because there is likely to be a move, even in employer-sponsored funds, towards personal pension accounts. The reasons for requiring

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[16] COM (99) 134 para. 30.

[17] COM (99) 134, box 5.

flexibility in the setting of minimum quantitative limits are as follows. The fund must be able to react to exceptional situations in the equity markets, to liquidity requirements and to reflect the optimal investment policies for funds with a large number of elderly contributors close to retirement who may require a higher investment in regular income such as bonds.

4. Currency Matching

The Commission is opening up the discussion on the necessity of a currency matching requirement[18]. FEFSI believes that a currency matching requirement is not necessary as the introduction of the Euro has reduced most needs for currency matching.

5. Freedom of Choice of Managers

FEFSI proposes to recognise in the directive that an approved DCPF manager may carry out several functions, including the following:

- Investment Management
- Fund Accounting
- Pension Administration Management
- Distribution/Marketing

FEFSI agrees fully with the Commission that pension funds should be able to use any provider of these functions approved in the EU[19]. The proposal should specifically allow credit institutions (2nd banking directive), life insurance companies (3rd life directive), firms regulated under the ISD and UCITS managers to be approved to act as DCPF managers. A DCPF organised as a single UCITS, however, may for the time being only be managed by a UCITS manager, in accordance with the UCITS directive (85/611/EEC), if it wants to be sold cross-borders. This provision is subject to change, however, if the proposed directive adapting the UCITS directive (85/611/EEC) is adopted in the future.

6. Reinvestment of Income

The Commission does not discuss further requirements for the investment of DCPF. FEFSI, however, believes that the directive makes clear that DCPF reinvest the income earned into the DCPF. This ensures that the compound interest effect is fully utilised to increase the value of the pension assets. Its impact on long investment periods are generally underestimated, even by experts, although it is in fact almost impossible to overestimate it. The following example illustrates this point using an amount of EURO 10,000.00 invested at 8 per cent over a period of 30 years with annual distribution. Over this period of 30 years the investment yields a total interest income of EURO 24,000.00. If however the income is reinvested and therefore the compound interest effect is used, the net income - all other things being equal - is more than EURO 90,000.00. A similar effect can be achieved by a continuous accumulation of savings.

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[18] COM (99) 134, para. 31.
[19] COM (99) 134, para. 32.