JOHANN WOLFGANG GOETHE
UNIVERSITÄT
FRANKFURT AM MAIN

Regulatory Challenges for Pan European Pensions

Raimond Maurer
Goethe University Frankfurt

Pension Challenges and Opportunities
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Numerical results are based on Horneff/Liebler/Maurer/Mitchell (2019). NBER WP 26406

The PEPP: Pan-European Personal Pension Product

- Adopted by European Parliament in 2019
- Standardized, portable, tax-qualified, funded personal pension (DC) product, complementary to public pensions offered by regulated financial institutions (e.g. asset managers, life insurers, banks)
- Use of capital markets
  - More investments into capital markets to meet the challenges of population aging and low interest rates.
  - Link long term savings to long term investments
- Access for all 220 Million workers in the EU
  - Open markets for all providers and all consumers
  - Portability of pension rights for mobile workers across the EU
  - Breakup fragmented markets for funded pension product in different countries

Regulatory Challenges 1: Taxation

- Within the usual EET deferred taxation incentive system and if worker move between different European countries, how much taxes must be paid to which country in case of withdrawals ?

  Example: Work for 20 years in Germany (max. marginal income tax 45%) + 20 years in France (50%), retire and make withdrawals in Malta (35%).

- PEPP should compromise national sub accounts
  - High administrative burden for providers
  - Complicated for consumers

- Would a TEE taxation system better for the PEPP across all Member States ?

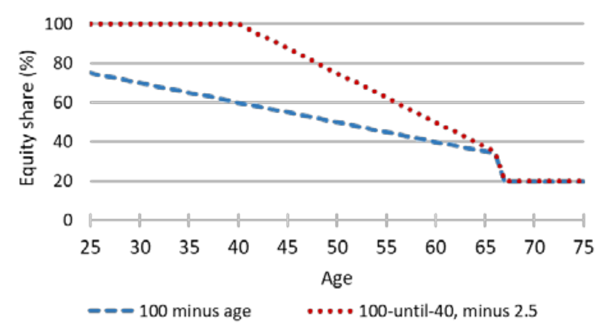
Regulatory Challenges 2: Accumulations
Basic PEPP (= default investment option)

- Default options are of key importance. Should be a safe product using ….
  - Guarantee of (at least) the contributions during accumulation phase
    - Esp. problematic for asset managers (solvency requirements)
    - In low interest rate environment guarantee costs very high!

	Interest Rate Scenario	
Investment horizon	0%	3%
Guarantee Costs Charged to Participant (% of contributions)		
10 years	19%	11%
42 years	36%	10%

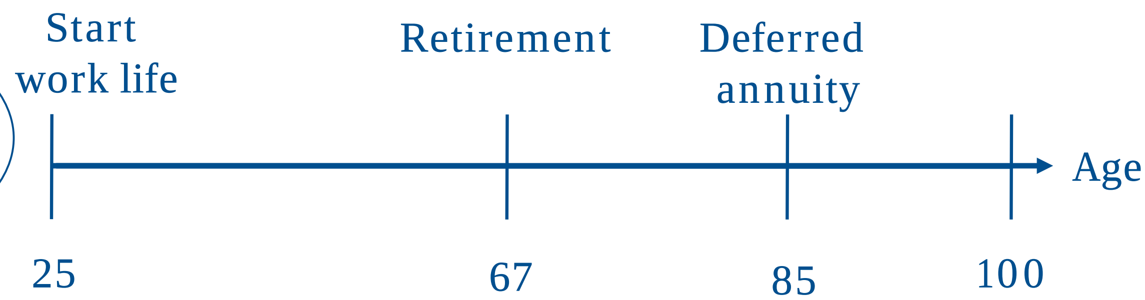
or

  - Other risk mitigation techniques (e.g. life cycle funds / target date funds) "with the objective to allow the PEPP saver to recoup the capital"
    - What are appropriate principles for life cycle funds?
    - Who is responsible ? → EIOPA



Testing Default Investment Options using a Life Cycle Model
(German framework)

Individual Preferences (CRRA)



Labor income: education, age, sex

State pension: payroll tax, benefits rules (point system)

Financial assets: equity, bonds, IRA (embeds deferred life annuity)

Institutional rules: taxation, subsidies; rules for Riester pensions

Housing cost / inflation

Numerical dynamic optimization;

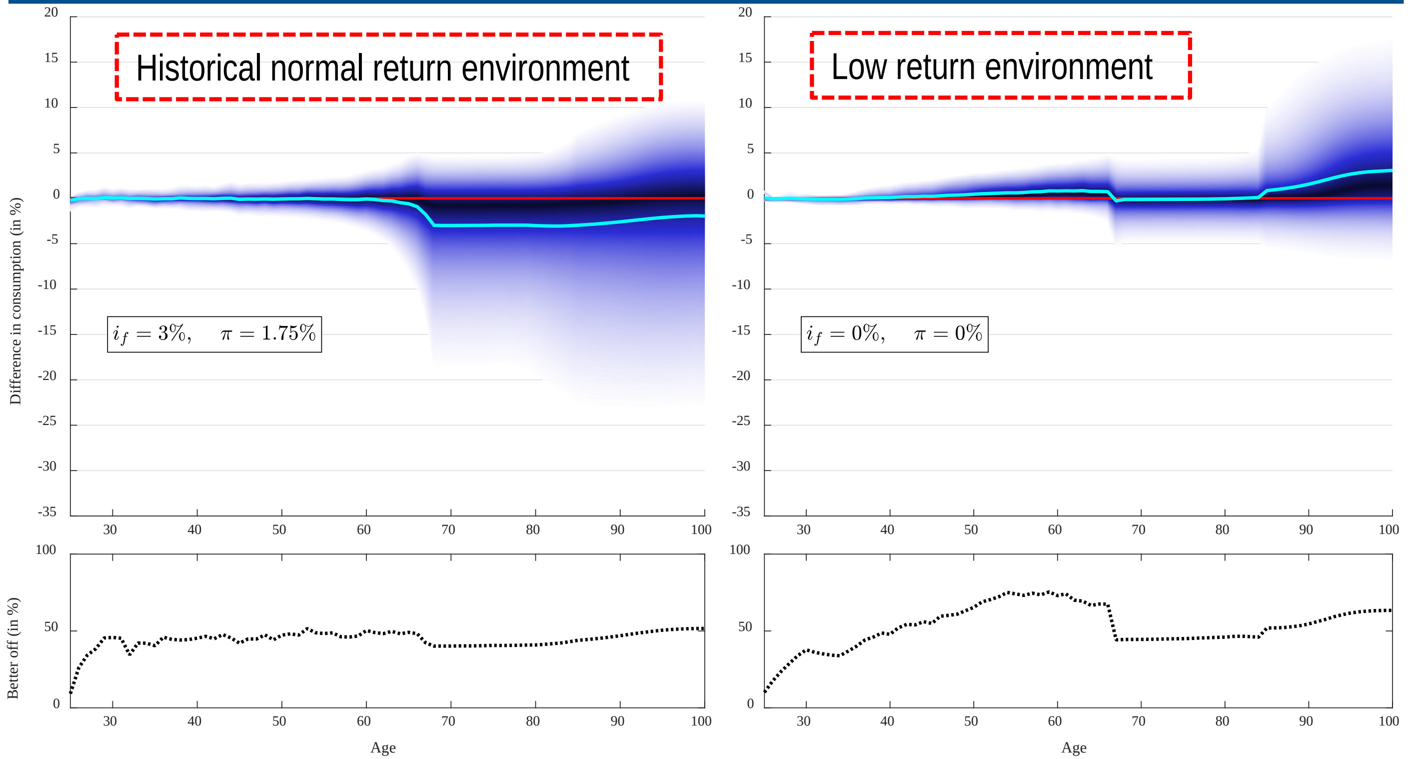
100K life cycles simulated

- Labor income
- Saving / consumption
- Asset allocation
- Asset location (in- / outside IRA)

Life cycle investing vs. with guarantee

Equity exposure:100-until-40, minus 2.5%-rule

Consumption with guarantee vs. life cycle IRA (in %)[1]



Savers with higher consumption

Prob.of higher consumption

Shortfall probability: 1.3%

Shortfall probability: 17.6%

[1] Relative to the case with a guarantee

Regulatory Challenges 3: Decumulations

- ✓ Currently the PEPP regulation is silent about payouts:
  - ➢ No mandatory annuitization required
  - ➢ No regulations for drawdown plans
  - ➢ No default payout option

Thank you!

Prof. Dr. Raimond Maurer

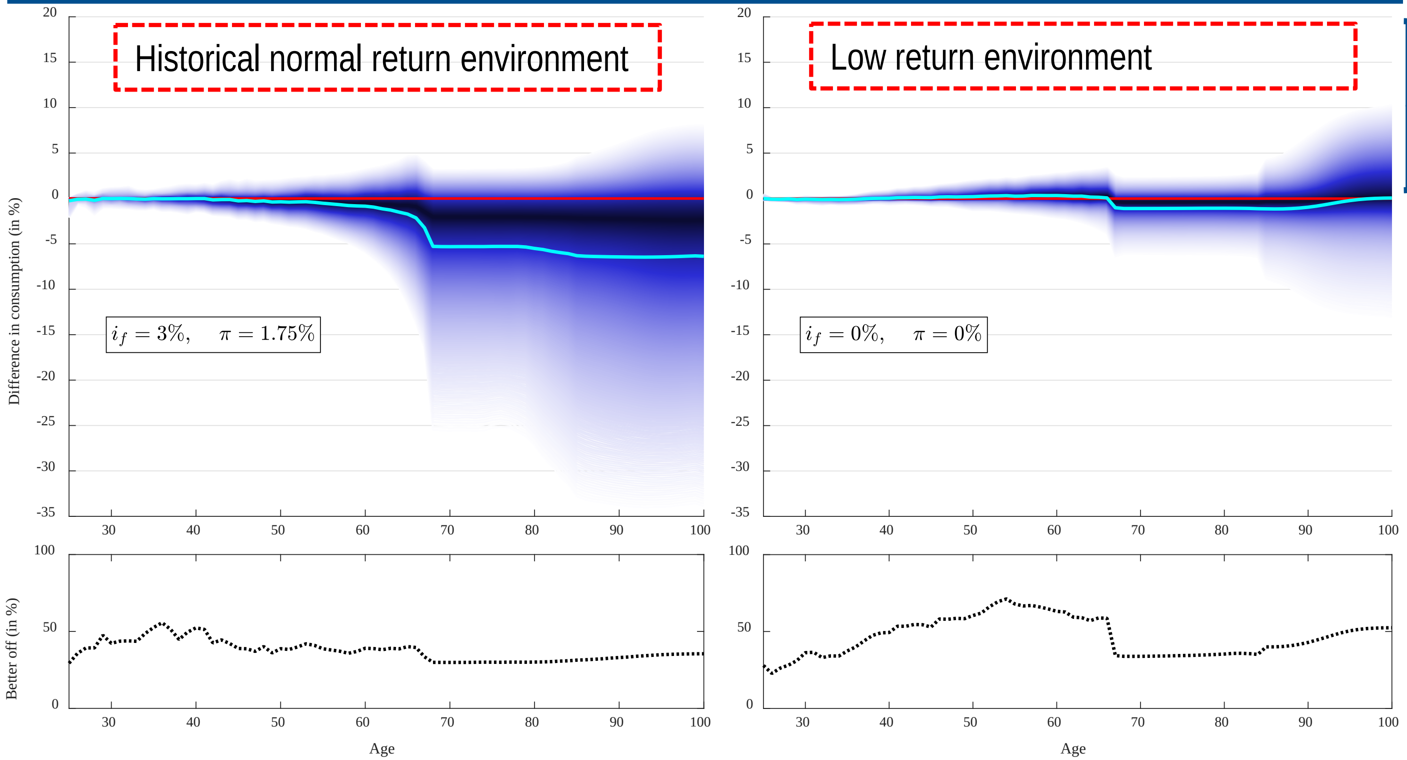
Raimond Maurer currently holds the Chair of Investment, Portfolio Management and Pension Finance at the Finance Department of the Goethe University Frankfurt. His main research interests focus on asset management, insurance, life-time portfolio choice, and pension finance. He received his habilitation and dissertation from Mannheim University and has various experiences in policy and industry consulting (e.g for the Worldbank, European Central Bank, FED, EU-Commission, EIOPA, e.g.). Dr. Maurer holds several professional positions like at the Union Real Estate Investment (Member of the Supervisory Board), the Society of Actuaries (academic chairman of AFIR group), the Association of Certified International Investment Analysts (academic director and member of the International Examination Committee), and the Pension Research Council at the Wharton School of the University of Pennsylvania (member of advisory board). He holds a degree of a honorary doctor from the State University of Economics St. Petersburg. Dr. Maurer has published several books and more than fifty refereed articles in leading international journals, including Review of Financial Studies, Journal of Financial Economics, Review of Finance, Journal of Risk & Insurance and the Journal of Economic Dynamics & Control. Prof. Maurer currently is the Dean of the Faculty of Economics and Business and Member of the Senate of the Goethe-University of Frankfurt.

Back up

Life cycle investing vs. with guarantee

Traditional *100 minus age*-rule

Consumption with guarantee vs. life cycle IRA (in %)[1]



Savers with higher consumption

Prob.of higher consumption

Shortfall probability: 0.8%

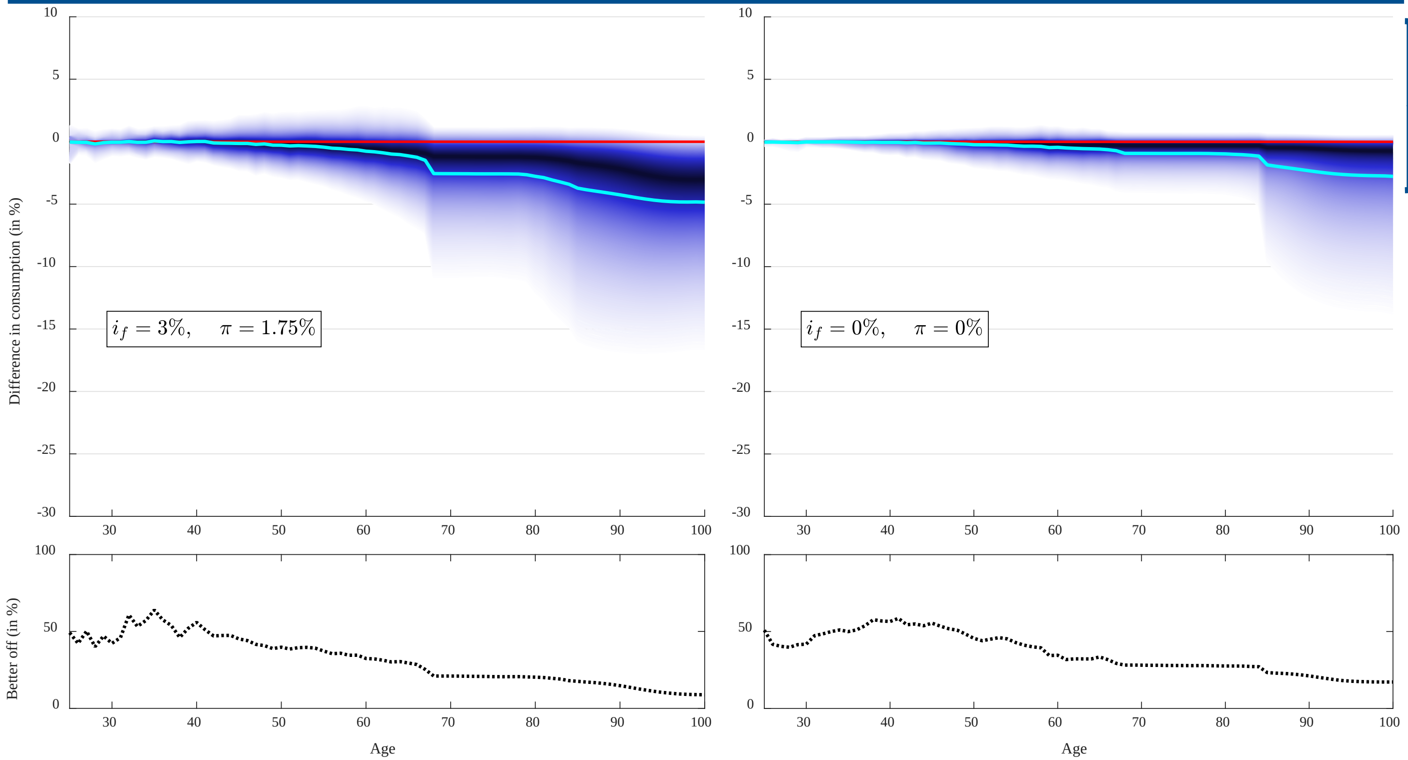
Shortfall probability: 18.7%

[1] Relative to the case with a guarantee

Life cycle investing: Impact of the equity share

100-until-40, minus 2.5% rule vs. *100-age* rule

Consumption for different life cycle IRAs (in %)[1]



Savers with higher consumption

Prob.of higher consumption

[1] Relative to the 100-until-40, minus 2.5% rule