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Regulating Pensions

Why the European Union Matters

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Regulating pensions: Why the European Union matters (extended version)

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1 Introduction

The way in which modern democracies have structured their pension systems is under severe pressure. This is obviously due to an omnipresent problem: ageing. The number of pension beneficiaries is increasing at a higher rate than the economically active population needed to fund the pension benefits. (Report EC ‘*Dealing with the impact of an ageing population in the EU*’, 2009).

The pressure on pension systems is a problem with which all Member States of the European Union are faced. A revision of pension systems is warranted.¹ Yet, the European dimensions of national pension systems remain underexposed, as many consider pensions as a purely national matter.

The European Commission has put pensions prominently on its policy agenda, most notably by its 2010 Green Paper entitled ‘*Towards adequate, sustainable and safe European pension systems*’ (herein after: the Green Paper”). In addition to the ageing issue and the problems directly related to it,² the challenges identified by the European Commission include changes to pension systems,³ the impact of the financial and economic crisis,⁴ and removing

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¹ In the Netherlands, the Labour Foundation presented the concept-Pension Accord Spring 2010 on 4 June 2010. This Accord proposes fundamental changes in occupational pensions in the second pillar. A year later the social partners presented the final Accord.

² For instance: women outlive men therefore should they still be treated equally?

³ This includes raising the retirement age, potentially rewarding late retirement and discouraging early retirement.

obstacles to mobility in the EU. The Commission explicitly states, however, that Member States are responsible for pension provision and that the Green Paper does not question Member States' prerogatives in pensions or the role of social partners.

The Commission has initiated a public debate to consult with all stakeholders about the identified challenges.⁵ In April 2011 the European Commission asked the new supervisory authority for insurance companies and occupational pension funds (EIOPA) for advice on the EU-wide legislative framework for IORPs. Advice is sought on the scope of the IORP directive, on certain cross-border aspects and on three other areas (EIOPA, '*Draft response to Call for Advice*').⁶

This paper explores how EU law affects national pensions systems, be it directly (by regulating pensions explicitly) or indirectly (by providing a regulatory framework that must be respected in the field of pensions as well as in other fields). Moreover, the focus will be on some fundamental questions: what should be the scope of the IORP directive? Which pension funds and schemes should be subject to it? How do we overcome the political dilemmas when regulating pensions?

The paper is structured as follows. In Part 2, the institutional framework regarding pensions will be addressed. Key issues include the question under what conditions the EU is competent to regulate pension matters and to what extent the subsidiarity principle requires the European Union to leave pension matters to the Member States. Part 3 explores how general EU policies affect or may affect pension systems. EU competition law and the free movement of services are the most notable amongst these policies. Part 4 focuses on the existing IORP-directive whereas part 5 argues that the current, highly fragmented and complex regulatory EU-framework regarding pensions should be clarified and discusses how to achieve such clarification.

2 The EU institutional regime regarding pensions

2.1 Introduction

⁴ To quote the European Commission: "By demonstrating the interdependence of the various schemes and revealing weaknesses in some scheme designs the crisis has acted as a wake-up call for all pensions, whether PAYG or funded: higher unemployment, lower growth, higher national debt levels and financial market volatility have made it harder for all systems to deliver on pension promises," Green Paper.

⁵ A website was launched especially for this purpose:

ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=839&furtherNews=yes.

⁶ Firstly, what quantitative requirements should apply to IORPs and how should these be measured. Secondly, what should be the qualitative requirements, particularly in respect of the governance of IORPs. Thirdly, what information should be provided in respect of IORPs to members and beneficiaries, and to supervisory authorities.

Is the EU competent to regulate pensions and if so, what aspects may be regulated at the EU level? Some consider pensions to be part of national autonomy and arguments to this extent have indeed had their effect on the adoption of the IORP-directive.⁷ Also the subsidiarity principle has been invoked in this regard. This principle requires decisions to be taken at the lowest level possible, to ensure that local preferences may be taken into account and that decisions are taken as closely to the citizen as possible.

In order to answer the question above, first, the constitutional system of EU competences must be considered. In political circles the issue of competences and subsidiarity are often confused. This may be understood from the fact that both principles relate to the question whether the European Union is allowed to regulate in a specific domain. The constitutional system of the EU, however, separates competences and subsidiarity and puts them into a consecutive order. If new legislation is considered at the EU level, it must first be established whether the EU is empowered to act in the field concerned. Only after this has been established and an appropriate legal basis has been found, the subsidiarity principle requires that an assessment is made whether the EU should indeed *exercise* such a power. The subsidiarity principle is, thus a principle that governs the exercise of EU competences rather than the establishment thereof.

2. 2 Competences in the field of pensions

The issue of competences is an expression of the legality principle at the EU level (Prechal, 2010). The attribution principle plays a key role in this regards as the EU is considered not to possess any ‘natural’ powers. All powers must therefore have been attributed to the EU by the Member States. The attribution principle is also crucial since the Member States have attributed no general legislative powers to the EU. Instead, only powers with regard to specific policy domains, or even parts thereof, have been attributed.

One of the most applied legal bases of the European Union concerns the regulation of the Internal Market (article 114 TFEU). This is perhaps the legal basis with the broadest scope of the Treaties. The CJEU has, however, determined that this legal basis may not serve as a general power to regulate the internal market. Legal acts on the basis of this provision need:

⁷ See section 4.

“to actually contribute to eliminating obstacles to free movement and to removing distortions of competition.” (*Germany v. Parliament and Council* case, 2000: 95)

Since this ruling, simple distortions (differences in national legal frameworks) do not suffice to justify EU actions. Only distortions that are *appreciable* and measures that make a *positive contribution* to the functioning of fall within the ambit of article 114 TFEU. Van Ooik, however, already observed prior to the CJEU’s ruling that it is hardly difficult to set up a reasoning in order to argue that differences in national legislation lead to inequalities in the market from which some may benefit and others suffer. (Van Ooik, 1999)

The case at hand concerned a classic conflict between an EU power and a national power. The directive imposed a complete tobacco advertisement ban. As the EU treaty explicitly excludes public health from harmonization, the directive was based on the Internal market legal basis. The CJEU annulled the directive, but stated that several elements might have been based on what is now article 114 TFEU. An EU wide ban on tobacco advertisements in e.g. magazines would ensure that free trade in such magazines is not hindered. Without such an EU wide ban, magazines might be marketed in some Member States, whereas in others it might not. Only for cases in which such a link with the internal market is totally absent article 114 TFEU would be inappropriate. Following the CJEU’s ruling, a new Tobacco advertisement directive with a smaller scope was indeed adopted. German challenged this new directive as well, but this time the CJEU upheld it.

The IORP- directive has also been (at least in part) based on the same provision, but the *Tobacco Advertisement* case is relevant for another reason as well. In previous case law, the CJEU had formulated the so-called *centre of gravity* test in case of overlapping powers (*Titanium dioxide Directive* case, 1991). Notably, this case concerned a horizontal overlap of powers, *i.e.* both powers concerned EU competences but containing diverging institutional arrangements on how to execute them. The CJEU concluded that the identification of the legal basis should be decided on the basis of the ‘centre of gravity’ of the measure or its ‘main purpose’. This would involve a balancing of the policy domains. One might have expected the CJEU to apply the same reasoning to vertical conflicts of powers, but the *Tobacco Advertisement* case is proof of the opposite. The ‘centre of gravity’ test has obviously been rejected. (Wyatt, 2010).

Consequently, national and European competences are not being balanced to assess what the main objective of a legal act is. The CJEU merely checks whether an EU act fits within the framework of article 114 TFEU, irrespective of whether the act concerned touches

upon national powers or even whether the main objective of such a measure belongs to the national domain. Arguments that have been put forward at the time of the adoption of the IORP-directive (see *infra*) that the Member States should retain ‘full responsibility’ for certain aspect of pensions law will be equally irrelevant should this form the object of an annulment procedure. It has been concluded that ‘no nucleus of sovereignty that Member States can invoke as such (exists) against the Community (Lenaerts, 1990). From a legal perspective, this conclusion can only be fully supported.

It all depends therefore on the political willingness of the legislative institutions to engage in further steps in the development of EU pensions law. It must be noted at this point that article 114 TFEU requires only a qualified majority of the Member States to favour a proposal in order to adopt it.

Several other legal bases exist apart from article 114 TFEU, although the latter is certainly most crucial for pensions. Some of these legal bases allow only for supporting measures (rather than the adoption of legislation). Such measures must then be restricted to soft law instruments such as Open method of Coordination (OMC). Article 148 TFEU, part of Title IX, employment, allows the Council, on a proposal from the Commission and after consulting the European Parliament, to adopt guidelines which Member States are obliged to take into account in their employment policies. Article 148(3) and (4) TFEU allow the Council to examine ‘the implementation of the employment policies of the Member States in the light of the guidelines for employment’ and to make recommendations to Member States. It does not constitute a legal base for the adoption of legislation *stricto sensu*.⁸ Article 136 TFEU allows the Council to adopt in accordance with procedures set out in Articles 121 and/or 126 TFEU, measures to strengthen the surveillance of Member States’ budgetary discipline, perhaps including, according to the pact of the Euro, aligning the pension system to the national demographic situation, for example by aligning the effective retirement age with life expectancy or by increasing participation rates and limiting early retirement schemes and using targeted incentives to employ older workers (notably in the age tranche above 55).(Conclusions of the Heads of States or Government of the Euro area, 2011). It should be pointed out that the IORP-Directive was adopted on the basis of (old) Articles 47(2) EC, 55 EC and 95 EC. This makes the Directive an internal market Directive and not a social policy

⁸ Opinion on the legal basis of the proposal for a regulation of the European Parliament and of the Council on enforcement measures to correct excessive macroeconomic imbalances in the euro area (COM(2010)0525 – C7-0299/2010– 2010/0279(COD)), 12 April 2011.

measure. This has been confirmed by the CJEU (*Commission v. Czech Republic* case, 2010) and confirms the prominent position of the Internal market legal bases.

2.3 Subsidiarity

In order to justify the national competences in the field of pensions, the so-called principle of subsidiarity is often invoked. This principle is a fundamental principle of EU-law. Apart from a legal perspective, the principle is viewed from a political and economic perspective as well (Gelauf, 2008). In this paper, the legal perspective on subsidiarity will prevail, with some references to political subsidiarity. The starting point is therefore article 5 TEU which provides that the EU:

“shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level (article 5 TEU).”

To understand the effects of this principle in the field of EU pensions, we must first analyze the developments it is currently subject to. In particular, the nature of the principle calls for further analysis. Its legal and political nature are both not sharply defined even though the principle had already been introduced by the Treaty of Maastricht in 1992. By some it was seen as a threat to the European integration process. Toth has described the introduction of the principle as a ‘retrograde step’ and predicted it would ‘weaken the Community and slow down the integration process’ (Toth, 1992). Clearly, the subsidiarity principle has indeed been seen as an important tool to protect the Member States from undesirable EU influence. However, the subsidiarity principle also has the opposite effect: it justifies EU action if and insofar as the EU is better suited to achieve policy objectives. Moreover, subsidiarity also serves as a constitutional principle to improve the link with citizens by ensuring that decisions are taken as closely as possible to them.

The subsidiarity principle has been difficult for the European Court of Justice to apply. The CJEU has always functioned to protect the EU legal order and to contribute to ‘an ever closer Union’. This position is perhaps difficult to reconcile with an assertive application of subsidiarity. The argument of the CJEU has been different, however, in that the principle is in essence a political principle and it has therefore limited itself to a procedural

test, *i.e.* checking whether the legislative institutions have indeed considered subsidiarity (Von Bogdandy, 2010). Despite numerous cases in which the Member States have invoked subsidiarity to challenge the legality of EU legislation, the CJEU has up until now never granted such a challenge. In more recent cases, however, the CJEU has shown more sensitivity to substantive rather than procedural aspects of subsidiarity.

In the *Vodafone* case (2010), the CJEU examined the Roaming Regulation, in particular the provisions on retail prices for mobile telephone services. The CJEU concluded that retail prices could be regulated at EU level on the basis of the interdependence of retail and wholesale charges. Regulation of both aspects at the EU level would, furthermore, imply that operators would be allowed to act within a single coherent regulatory framework. Thus, the argumentation of the CJEU included an analysis of the substance of the regulation instead of merely carrying out a procedural check (van den Brink, 2011).

The earlier position of the CJEU is, however, understandable. The subsidiarity principle is indeed difficult to interpret in an objective manner. Unlike the attribution principle, the subsidiarity issue remains to a high degree an issue that depends on subjective application by policy makers. No legislative proposals are *a priori* contrary to the subsidiarity principle; this will depend on the actual content of such proposals and the context to which they are to be adopted. Subsidiarity is, therefore, a dynamic principle. If the circumstances require an expansion of EU action, the principle justifies such an expansion. This implies that the question what action at the EU level complies with the subsidiarity principle may evolve over time. This also implies that existing legislation may be deprived of its legitimacy if changed circumstances no longer justify action at the EU level. This dynamic nature of the principle was made explicit in the Old Subsidiarity and Proportionality Protocol (attached to the treaties). This Protocol also reflected the rather subjective nature of subsidiarity. It contained a number of indicators, rather than strict criteria, to provide guidance in the application of the subsidiarity principle:

- the existence of transnational aspects;
- abstaining from Community measures would conflict with the requirements of the Treaty or would otherwise significantly damage Member States' interests;
- Community measures would produce clear benefits by reason of its scale or effects.

The legislative institutions of the EU are called upon to apply subsidiarity and consider the elements from the Protocol. The Subsidiarity Protocol further provided that directives were to be preferred over regulations; that EU measures should leave as much scope for national discretion as possible and that “well-established national arrangements and the organization and working of Member States' legal systems” should be respected.

The old Protocol has been withdrawn and replaced by a new Subsidiarity and Proportionality Protocol that no longer contains any references to a substantive interpretation of subsidiarity. This has been effectuated by the Treaty of Lisbon. The above-mentioned article from the EU Treaty is now all what is left. The new Protocol, however, greatly strengthens subsidiarity. This is achieved in two, more institutional and procedural, ways. First, national parliaments are entrusted with the power to review legislative proposals in the light of subsidiarity. Second, the new Protocol contains an extra possibility for Member States to challenge legislation on the basis of subsidiarity. National parliaments may initiate such proceedings.

Inevitably, the subsidiarity principle has thus gained importance since the entry into force of the Lisbon treaty. The political nature of the principle has been strengthened (as a result of the new powers for national parliaments) as has its legal nature (as a result of the enhanced judicial procedure). Any new legislation in the field of pensions is, thus, subject to this new regime. National parliaments lack the capacity to scrutinize all EU legislative proposals. Selection is, thus, necessary. Legislative proposals in the field of pensions are, however, likely to be selected as they are perceived to affect national autonomy. Scrutinizing legislative proposals may lead to a compulsory reconsideration of a proposal if a sufficient number of national parliaments oppose such a proposal on the basis of subsidiarity. But national parliaments possess not only collective, but – with the possibility to initiate legal proceedings – individual power as well.

Although the formal changes to subsidiarity of the Lisbon Treaty are institutional and procedural, the effects thereof may turn out to be of a substantive nature. Firstly, national parliaments search for more or less objective criteria (Van den Brink, 2011). Rather than using the new mechanism for scrutiny merely for political arguments, first experiences indicate that they actually focus on the issue what the best level of regulation is. Moreover, they cooperate in the framework of COSAC, a framework which allows for the exchange of information on the application of the subsidiarity control mechanism. The desire to develop objective criteria has been voiced by e.g. the Irish *Oireachtas*. Thirdly, experiences in Germany indicate that a more legal and more objective approach to subsidiarity is a viable

alternative. The German constitutional system contains an internal subsidiarity principle that regulates the exercise of legislative competence between the *Bund* and the *Länder*. Legislative action at the federal level is appropriate if this is necessary to achieve:

- 1) legal unity;
- 2) economic unity or:
- 3) equality of living conditions.

Without losing the dynamic nature of subsidiarity, the Germans have succeeded in objectifying subsidiarity in such a way that a genuine focus on the three constitutive elements of subsidiarity has been realized (van den Brink, 2011a). Not only the German legislative institutions, but also the Federal constitutional court reviews legislation in the light of these three elements. As such, this may provide an alternative for the further development the subsidiarity principle in the European Union. The strengthening of the subsidiarity principle by the Treaty of Lisbon has yet to be transformed into substantive effects. It is uncertain how this will take shape precisely, but that substantive effects must be expected is beyond doubt.

These general observations on subsidiarity affect the application of the principle in the field of pensions. The adoption of the IORP-directive has given rise to a rather intensive debate on what the effects of subsidiarity should be. This has led to the inclusion of a recital (number 9) in the Directive which reads as follows:

“In accordance with the principle of subsidiarity, Member States should retain full responsibility for the organisation of their pension systems as well as for the decision on the role of each of the three "pillars" of the second pillar, they should also retain full responsibility for the role and functions of the various institutions providing occupational retirement benefits, such as industry-wide pension funds, company pension funds and life-assurance companies. This Directive is not intended to call this prerogative into question.”

This recital clearly suffers from a wrong interpretation of the subsidiarity principle as explained above (Van Meerten and Starink, 2011). In fact, the argumentation fits the attribution/legal basis principle better than the subsidiarity principle. Indeed, the argumentation seems to be that two aspects are a priori excluded from EU competence, *i.e.* the organization of pension system and the balancing of the three pillars. Even at present when the subsidiarity principle has only just started to take shape, it is clear that it is not

suites to form *a priori* obstacle to specific legislation. Whether action at the EU level is appropriate should depend on an analysis of the context and circumstances of the area that needs to be regulated. Furthermore, an *a priori* exclusion of such domains from EU regulation fits badly with the dynamic nature of the principle which requires that room is made to assess new developments and changed circumstances.

For the development of pensions law at the level of the European Union, the consequences are the following. First, the situation should be considered in which the majority of member states should agree that further steps in this area are indeed necessary even if that would affect the organization of pension systems or the role of the ‘pillars’. A Member State that would find itself isolated in the decision making process, has the formal possibility of addressing the European Court of Justice. Given the constitutional meaning of subsidiarity, it is, however, highly unlikely that it would find the CJEU at its side. Even the fact that the EU legislature has given a concrete meaning to subsidiarity and identified concrete effects thereof when adopting the IORP-directive will not change this.

Second, rather than an upfront exclusion of EU legislative action and the formulation of national prerogatives, the subsidiarity principle will increasingly be applied to enhance the legitimacy of EU action. It may be expected that this development that has started to develop in other areas, will emerge in the field of pensions as well. This would imply that national parliaments as well as European institutions will focus increasingly on ‘facts and figures’. Thus, the subsidiarity principle becomes a vehicle for evidence based policy making. In the dossiers selected for subsidiarity scrutiny up until now, national parliaments have focussed on issues such as the scope of the cross border effects of the situation, the expected economic benefits of EU regulation, the scale of the problem or the issue to be regulated and the national benefits at stake. Legitimacy of EU action thus becomes a matter of scale: the more data are put forward to substantiate e.g. the scope and scale of the problem, the more justified it is to adopt legislation at the EU level. This way, subsidiarity may turn into an extra rule of motivation of EU proposals. In other cases, subsidiarity will serve as a leading principle to obtain a correct mix of measures at the EU level and measures at the national level. The reservation of national prerogatives remains, however, difficult to combine with either one of these roles.

3 EU substantive law and EU pensions

3.1 Introduction

As the provision of pensions constitutes an economic activity, they will normally be considered services within the meaning of EU law. According to Article 57 TFEU, services are normally provided for remuneration. The Court has, for instance, recognised that health care constitutes a service within the meaning of this provision, whenever a patient moves to another Member State to pay and receive medical care there. In a similar vein the regulation of pensions and pension schemes may fall under the EU internal market rules, i.e. the free movement of services and the competition rules, whenever there is an effect on interstate trade. It is therefore important to bear in mind that apart from the legal regime established by the IORP-directive, the Treaty rules – primary EU law - may apply ultimately setting the limits to Member States' powers to regulate the field of pensions.

Apart from the Member State, pension funds themselves must, through their activities on the market, respect the EU internal market rules as well. The free movement of services as guaranteed by Article 56 TFEU has (limited) horizontal direct effect and is also directed at pension funds. The EU competition rules are specifically directed at undertakings, including pension funds, according to the case law of the CJEU (see hereafter).

At the same time, the crucially social dimension of pensions cannot be denied. Pensions are social benefits whereas pension funds operating pension schemes often carry out specific *public service tasks* – also called services of general economic interest (hereafter: SGEI) - laid down by law operating on the basis of the principle of solidarity thereby guaranteeing the pension rights of affiliated workers. The Treaty takes account of such public, social, interests and grants Member States as well as undertakings a possibility to justify restrictions on the free movement of services and on the competition rules, which arise out of the regulation of the pension market.

The key Treaty provision on SGEI is unquestionably Article 106(2) TFEU containing an exception ground for undertakings entrusted with the operation of SGEI, but can be invoked by undertakings as well as by the national state:

“Undertakings entrusted with the operation of services of general economic interest [...] shall be subject to the rules contained in the Treaties, in particular the rules on competition, in so far as the application of such rules does not obstruct the performance, in law and in fact, of the particular tasks assigned to them.”

Article 106(2) TFEU serves to reconcile internal market and competition requirements with Member States' desire to deliver public services. The provision has considerable importance in balancing Member States' interference with the competition rules and the supply of SGEI, or, in other words, in the choice between market values and other values. The extent to which Article 106(2) TFEU could also play a role in the context of the free movement provisions in addition to the justification grounds, which are laid down in either the Treaty itself or in the case law of the CJEU is not entirely clear. The Court had the opportunity to rule on this question in the *Servatius* case (2009) concerning a Dutch authorization scheme for investments in housing projects by housing corporations in other Member States, as one of the arguments of the Dutch authorities was that the scheme was justifiable for the protection of social housing services. But the Court decided not to answer this question of the Dutch Council of State and only applied the Treaty rules on free movement of capital to this case.

It would have been interesting to know the Court's thoughts on this matter, since Article 106(2) TFEU might have a wider scope than the mandatory requirements within the context of the free movement rules. After all, services of general economic interests allow for the justification of market and non-market services by virtue of a general interest criterion; mandatory requirements are of a purely *non-economic* nature, although the case law is evolving in this respect (de Vries, 2006).

Article 106(2) TFEU has played a vital role where Member States grant exclusive or special rights to undertakings for public service reasons but is relevant for other Treaty provisions as well, like Article 107 TFEU on state aids. If Member States grant financial aid to undertakings to compensate public service obligations imposed upon them, Article 106 TFEU will be applicable.

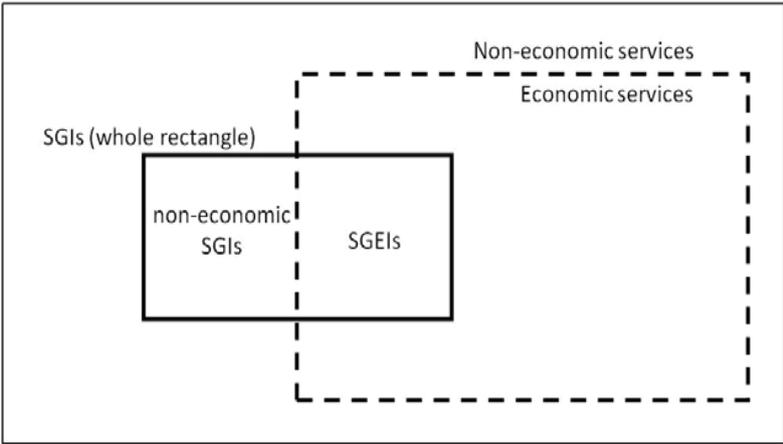
In the following the developments regarding services of general economic interest will be viewed through the prism of a changing constitutional setting in Europe, which is partially the result of the entering into force of the Treaty of Lisbon. The advancement of a social market economy, for example, has, since the Treaty of Lisbon, been included amongst the fundamental objectives of the European Union. Furthermore, recent case law, especially in non-liberalized sectors like healthcare (*BUPA* judgment), emphasize the merely ancillary and supportive role of the European Union in this field. This approach fits well in the sovereignty debate in Europe and appears to meet the Member States', or even citizens', demands, to

increasingly decide for them how social issues like healthcare must be handled by their government.

3.2 SGEI and the scope of the EU competition rules: the concept of undertaking

Article 106(2) TFEU comes into play only when undertakings are engaged in economic activities. Non-market services, which are not covered by the concept of ‘undertaking’ as defined in the Court’s case law are excluded from the scope of Article 106(2) TFEU. According to the Commission services of general *economic* interest refer to market services which are subjected to specific service obligations by virtue of a general interest criterion (Green Paper on Services of General interest, 2003:6-7). But *services of general interest* cover market and non-market services. In the protocol on Services of General Interest attached to the Treaty both services of general economic interest and services of general interest are mentioned. And, according to Article 2 of the Protocol, the provisions of the Treaty do not affect in any way the competence of Member States to provide, commission and organize *non-economic* services of general interest. This provision appears to be redundant, as after all these services will not be caught by the internal market rules in the first place.

The following diagram drawn up by Hancher and Larouche may be illustrative in this respect (Hancher and Larouche 2007):



Hence it is crucial for the applicability of Article 106(2) TFEU to first define the concept of undertaking. Regarding pensions, it must be assessed to what extent pension funds can be considered as undertakings. According to the definition provided by the Court in *Höfner*

(1991:21) and subsequent cases the concept of undertaking encompasses “every entity engaged in an economic activity, regardless the legal status of the entity and the way it is financed”. The functional character of the concept of undertaking, which implies that the type of activity performed rather than the characteristics of the actors which perform it is relevant, the social objectives associated with it, or the regulatory or funding arrangements to which it is subject in a particular Member State, entail that all sorts of public interests can be brought within the ambit of the competition rules.

Nevertheless, according to the case law of the CJEU certain activities cannot be classified as economic and are therefore excluded from the scope of the application of the competition rules. The rules on competition do not apply to an activity (i) which is connected with the exercise of the powers of a public authority; or (ii) which by its nature, its aim and the rules to which it is subject does not belong to the sphere of economic activity (*Wouters* case, 2002:57). Regarding the latter the competition rules may not be held applicable for bodies, which fulfil a social function and are subject to state control. This may be relevant for pension funds as well, as par. 3.5 will show.

Hence, solidarity arguments are in the first place crucial to determine whether certain sectors are within the scope of the competition rules or not and if they are dominant, the state will be able to bring parts of the sector outside the ambit of the EU market rules without having to invoke a provision like Article 106(2) TFEU. An example is the healthcare sector, where managing bodies of healthcare systems, like health insurers, are involved. Managing bodies are undertakings depending on the degree of solidarity or competition built in the system. If the principle of solidarity is predominant, the managing bodies are, according to the case law of the Court, not performing economic activities (van de Gronden, 2009). The more competition is being brought into the healthcare system, however, the greater the economic connotation will be and hence the higher the chance that the competition rules will apply. The same goes true for the pension sector. In *Albany* (1999) the CJEU held that a pension fund charged with the management of a supplementary pension scheme is an undertaking within the meaning of the Treaty. Apart from the principle of solidarity the CJEU has made clear in its case law that it is necessary to analyse the scope of the State’s control, for example, over how the pension scheme functions (*AG2R Prévoyance* case, 2011).

This matter will be further discussed in par. 3.5.

3.3 Defining SGEI

Once it is clear that pension funds are - in principle - undertakings, it can be assessed whether the funds can be qualified as undertakings which are entrusted with services of general economic interest.

Related to market failure: 'Backpack approach'

A key value of welfare systems in the Member States of the European Union is universal access or coverage (Neergaard, Nielsen and Roseberry, 2009). Taking healthcare as an example, all citizens should have access to healthcare and access for all must be ensured, according to the Council in its Communication on common values and principles of the healthcare systems of the Member States (Council Conclusions on Common values and principles in European Health Systems, 2006; Van de Gronden, 2009). To guarantee universal coverage the national government plays a vital role, not only in state-oriented welfare systems but also in market-oriented systems. The markets for healthcare but also for pension schemes are characterized by several instances of market failure, such as information asymmetry and risk selection (Lavrijssen and De Vries, 2009).

In market-oriented systems where welfare services are no longer or only partly determined by government regulation of the supply side public interests, such as affordability, accessibility and good quality of care, must be protected, for instance, by a system of regulated competition and by imposing public service obligations on undertakings. This is also referred to as the 'backpack approach', meaning that only where markets, in the absence of governmental regulation, would fail to deliver public services, the government is 'justified' to impose obligations on undertakings to safeguard universal services (Hessel, 2006). In both state and market-oriented systems, the Member State provides for subsidies or other forms of financial measures to support welfare services, ultimately with a view to guarantee universal coverage.

SGEI linked to universal service

The concept of services of general economic interest is thus linked to the notion of *universal service*, which is relevant for consumers as they should have continuous access to high quality services at affordable prices. Universal service has been defined as follows:

“(T)o guarantee access for everyone, whatever the economic, social or geographic situation, to a service of a specified quality at an affordable price.” (European Commission, Green Paper on Services of General interest, 2003:4)

Another definition offered by the Commission in its Green Paper is:

“The concept of a universal service refers to a set of general interest requirements ensuring that certain services are made available at a specified quality to all consumers and users throughout the territory of a Member State, independently of geographic location, and in the light of specific national conditions, at an affordable price.” (4)

A key characteristic of universal service is that it can be qualified as a universal right for consumers on the one hand and a set of obligations for undertakings on the other (Sauter, 2008). But SGEI may stretch beyond the notion of universal service, since undertakings are allowed to perform public services under economically acceptable conditions, which may, according to the Court in *Corbeau* (1993), involve non-universal services if necessary to enable the provision of public services. This is confirmed in the *Brentjes* case (1999) which concerned the compulsory affiliation to a sectoral pension fund in the Netherlands and its compatibility with the EU competition rules, and in recent case law, like the above-mentioned *AG2R Prévoyance* case. The Court uses a proportionality test to safeguard access for consumers to universal and high quality services, which are delivered at reasonable prices. By applying the proportionality principle under Article 106(2) TFEU the Court in fact seeks to prevent on the one hand that public service undertakings cannot perform their tasks under economically acceptable conditions anymore, on the other that *other* undertakings cannot offer specific services for which there is a consumer demand (*Corbeau* case, 1993; *Ambulanz Glöckner* case, 2001; de Vries, 2006: 167-168).

Notwithstanding the above-mentioned approach in the case law of the CJEU in EU law no clear connection is otherwise made between the notion of market failure and the concept of SGEI, at least not in sectors which are not or hardly subject to EU secondary legislation. It is obvious that here universal coverage and universal access are key principles of welfare services as part of services of general economic interest. But Member States decide on how universal coverage and access are to be realized, due to the fact that Member States have the competence to define public services. At EU level a coherent set of, for instance, ‘pension principles or competences’ is lacking (See van Gronden, 2009 regarding the health

sector). Yet at the same time the EU Institutions have to safeguard competition in the market, which leads to tensions.

Citizenship dimension of SGEI

The meaning of services of general economic interest is furthermore highlighted by the fact that under the Charter of Fundamental Rights (Article 36) not only consumers but also citizens in general should have a right of access to SGEI (see hereafter, section 3.2)

Dynamic character of SGEI

Apart from the above-mentioned features, services of general economic interest have a dynamic character. According to the EC in its Green Paper (Green Paper on Services of General interest, 2003) the range of services that can be provided on a given market is subject to technological, economic and societal change.

3.4 SGEI and the Treaty context: constitutional dimension

Treaty provisions relevant to SGEI

As a preliminary remark it must be stressed that the core provision on services of general economic interest, i.e. Article 106(2) TFEU, has been left untouched by the Lisbon Treaty. But the Treaty of Amsterdam introduced another provision, Article 16 EC (now Article 14 TFEU), which could at the time be seen as a “first step in the constitutionalization of the services of general economic interest” (Prechal, 2009:67). According to Article 16 EC services of general economic interest are given a place in the shared values of the Union and have a role in promoting social and territorial cohesion. Furthermore, “the Community and the Member States, each within their respective powers and within the scope of application of this Treaty, shall take care that such services operate on the basis of principles and conditions which enable them to fulfill their missions”.

It was held at the time that Article 16 EC in combination with Article 86(2) EC (now Article 106(2) TFEU) merely articulated the value of services of general economic interest to Member States and the Community. Apart from this, Article 16 EC had an independent and additional role and function in Community law (Ross, 2000: 22-38). The additional value of Article 16 EC was considered twofold. First, it made clear that the function of services of

general interest stretched beyond the field of competition. And second, it entailed that the traditional approach to interpret derogations from the free movement and competition rules restrictively should be abandoned (Ross, 2000:38).

The Treaty of Lisbon 2009 introduced three new features to Article 14 TFEU. First, the provision has been inserted in the Chapter on Principles and under Title II (provisions having general application). These provisions have a transversal character and require, more than the EC Treaty did, the EU to take account of these principles in all of its activities (Prechal, 2009:68). Second, Article 14 TFEU is rendered more specific by including a reference to *particularly economic and financial conditions* as part of the principles and conditions on which basis services of general economic interest must operate to fulfil their public service mission, although it is as yet unclear what the precise impact of the insertion of this reference will be (Amentbrink and Van de Gronden, 2008). It is assumed that it emphasizes the Member States' broad discretionary powers in this respect.

Third and last, Article 14 TFEU offers a legal basis for the adoption of Regulations at EU level, which shall establish the principles and conditions, without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services. This provision is more weakly formulated than the previously proposed provision of the Constitution, Article III-122, stipulating that:

“European laws shall define these principles and conditions.”

However, it still provides for an important (additional) legal basis granting the Council and European Parliament the power to develop comprehensive rules at EU level. But two points of criticism have been raised regarding this provision. Firstly, the fact that Article 14 TFEU only refers to *principles and conditions* would possibly exclude the adoption of detailed provisions at EU level, for example, with a view to modify the outcome of case law. And secondly, the fact that the provision only enables the adoption of *Regulations* and not of *Directives* seems to be at odds with the idea that Member States must remain primarily responsible for the definition and entrustment of services of general economic interest (Krajewski, 2008). And for that matter it was a Framework *Directive* that was proposed by the Socialist Group in the European Parliament a couple of years ago.⁹

The Protocol attached to the Treaty

⁹ To be found at:

http://www.socialistgroup.org/gpes/media3/documents/1917_EN_public_services_en_november_2006.pdf.

The importance of services of general economic interest also appears from the Protocol on Services of General Interest, which is attached to the Treaty of Lisbon (Protocol No. 26). Article 1 of the Protocol states the following:

“The shared values of the Union in respect of services of general economic interest within the meaning of Article 16 of the Treaty on the Functioning of the European Union [now Article 14 TFEU] include in particular:

- the essential role and the wide discretion of national, regional and local authorities in providing, commissioning and organizing services of general economic interest as closely as possible to the needs of the users;
- the diversity between various services of general economic interest and the differences in the needs and preferences of users that may result from different geographical, social or cultural situations;
- a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights.”

Article 2 of the Protocol states:

“The provisions of the Treaties do not affect in any way the competence of Member States to provide, commission and organize non-economic services of general interest.”

On the one hand the Protocol can be seen as a particular expression of the Member States’ wish to keep control over services of general economic interest (Sauter, 2008:173). On the other hand it can be viewed as an incitement for the EU to develop a European approach to services of general economic interest (Amentbrink and Van de Gronden,2008). The question is whether this Protocol does, in fact, add something substantial to the concept of services of general economic interest. Although the Protocol may indeed not as such alter the law as it stands, it does contain interpretative provisions, which confirm the central role of national (and sub-national) entities to provide services of general economic interest (Prechal, 2009:68).

Some would argue that, irrespective the insertion of Article 16 EC, the Protocol on Services of General Interest, accompanying documents and the amendment of Article 16 by the Treaty of Lisbon 2009 by Article 14 TFEU, from a strictly legal perspective nothing has changed. After all Article 14 TFEU clearly states that it applies without prejudice to Articles

93, 106 and 107 TFEU. And the concept of services of general economic interest seems highly politicized (Vedder, 2008). The rhetoric surrounding services of general economic interest could simply be understood as merely political fireworks. In this ‘scenario’ it is not difficult to imagine that judicial bodies may easily become *captured* by politics.

But the above-described legal developments cannot be left wholly unnoticed or merely classified as ‘political’. It has also been argued that the insertion of Article 16 in the EC Treaty at the time constituted a first important step in the constitutionalization of services of general economic interest.

Charter of Fundamental Rights of the EU

Under Chapter IV ‘Solidarity’ of the Charter of Fundamental Rights a number of provisions come into the picture. Firstly, Article 36 of the Charter of Fundamental Rights is relevant for *all* sectors where services of general economic interest are at issue and states:

“the Union recognizes and respects access to services of general economic interest as provided for in national laws and practices, in accordance with the Treaty [...], in order to promote the social and territorial cohesion of the Union”.

Although not couched in terms of individual enforceable rights for individuals, it does emphasize the importance of services of general economic interest in the EU and should therefore have an impact on how Community Institutions, including the Community Courts, should act or abstain from taking action (Prechal, 2008:69). The fact that the Charter, since the Treaty of Lisbon 2009 came into force, is now legally recognized and binding is significant:

“as it can now more easily and more vigorously be deployed as a standard for judicial review of Union measures and national measures implementing Union law and as an aid to interpreting national and Union measures.”(Chalmers and Monti, 2008:69)

In any event, the inclusion of services of general economic interest in the Charter of Fundamental Rights emphasize the fundamentality and universality of access to welfare services, which should steer the orientation and interpretation of competition rules, also in sectors like the pension sector. The question remains: *how?*

3. 5 The case law

As already briefly discussed, in the case of *AG2R Prévoyance*, an interesting matter was put before the CJEU. The case shows great similarities with the *Albany* case although unlike the pension fund at issue in *Albany*, affiliation to which was compulsory subject to exemptions, the scheme for supplementary insurance to cover healthcare costs in the *AG2R* proceedings made no provision for exemption from affiliation. The CJEU attached no special weight to the existence of that exemption from affiliation in its interpretation of Article 101(1) TFEU (Opinion to *AG2R Prévoyance* case, 2011:41), which makes the case very important for occupational pension provision systems with compulsory membership.

Let it however again be stressed that whether the activities of the fund and/or the scheme can be classified as of SSGI or SGI is not so much relevant.¹⁰ What matters is whether *the activity* in question qualifies as ‘economic’. If the answer is affirmative, the competition and/or internal market rules apply. Therefore, SSGIs may be of an economic or non-economic nature, depending on the activity under consideration.¹¹ The fact that the activity in question is termed ‘social’ is not of itself enough (*Pavlov* case, 2000) for it to avoid being regarded as an ‘economic activity’ within the meaning of the CJEU's case law. SSGIs that are economic in nature are SGEIs.

The question of how to distinguish between economic and non-economic services has often been raised, and the answer cannot be given *a priori*. It requires a case-by-case analysis. (Report European Commission on services of general interest, 2007). A single institution may well be engaged in both economic and non-economic activities and therefore be subject to competition rules for *parts* of its activities but not for others. The Commission points at the following examples (Report on services of general interest, 2007). The CJEU has ruled that a given entity may be engaged on the one hand in administrative activities which are not economic, such as police tasks, and on the other hand in purely commercial activities (*Aéroports de Paris* case, 2003). An entity can also be engaged in non-economic activities where it behaves like a charity fund and at the same time compete with other operators for another part of its activity by performing financial or real estate operations, even on a not-for-profit basis (*Cassa di Risparmio di Firenze* case, 2006). According to this functional approach, each

¹⁰ There is no general EU legislative framework applicable to SSGIs, hence they are subject to the legal regime of SGIs. However, some EU-law imposes a different legal regime so SSGIs, such as exclusion from the area of application of Services Directive. Van Meerten 2008.

¹¹ Confirmed by the Commission: SEC(2010) 1545 final, ‘Guide to the application of the European Union rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest’.

activity has therefore to be analysed separately (*Commission v. Italy case*, 1987). It is of course, as AG Jacobs argued, “difficult to arrive at any precise statement of the point at which the redistributive component of a pension or insurance scheme will be so pronounced as to eclipse the economic activities which private pension and insurance providers compete to supply. Schemes come in a wide variety of forms, ranging from State social security schemes at one end of the spectrum to private individual schemes operated by commercial insurers at the other.” (Opinion to Joined Cases *AOK Bundesverband and Others*, 2004: 35) Classification is thus necessarily a question of degree.

In the context of social security, the CJEU has established two main criteria for determining whether or not the activity in which the body or bodies responsible for the various schemes concerned is/are engaged is economic in nature (*AG2R Prévoyance case*, 2011) The CJEU examines, first, whether the scheme at issue applies the principle of solidarity and, secondly, the extent to which that scheme is subject to control by the State: if the scheme applies the principle of solidarity and is under State control, the body in charge of managing the scheme will be considered not to be engaged in an economic activity and will therefore fall outside the scope of the competition rules (*Kattner Stahlbau case*, 2009). In *Albany* the CJEU held that a pension fund charged with the management of a supplementary pension scheme set up by a collective agreement concluded between organisations representing employers and workers in a given sector, to which affiliation has been made compulsory by the public authorities for all workers in that sector, is an undertaking within the meaning of the Treaty. The pension fund in *Albany* was entrusted with one scheme only and this scheme met the solidarity criteria. The CJEU remained however vague about the necessary level of solidarity of the scheme in order to justify the breach of competition law.¹² The CJEU:

“Third, operation of the sectoral pension fund is based on the principle of solidarity. Such solidarity is reflected by the obligation to accept all workers without a prior medical examination, the continuing accrual of pension rights despite exemption from contributions in the event of incapacity for work, the discharge by the fund of arrears of contributions due from an employer in the event of the latter's insolvency and by the indexing of the amount of the pensions in order to maintain their value. The principle of solidarity is also apparent from the absence of any equivalence, for individuals,

¹² As Drijber rightly argued, this reasoning of the ECJ in *Albany* is rather odd. First the ECJ held that granting an exclusive right is not as such contrary to Article 86 EC in conjunction with Article 82 EC but then held that the exclusive right to its very nature restricts competition, which requires justification. See (in Dutch): Drijber 2007.

between the contribution paid, which is an average contribution not linked to risks, and pension rights, which are determined by reference to an average salary. Such solidarity makes compulsory affiliation to the supplementary pension scheme essential. Otherwise, if 'good' risks left the scheme, the ensuing downward spiral would jeopardise its financial equilibrium.”(75)

In following case law the CJEU did not develop universal solidarity criteria. Also here, determining the level of solidarity requires a case-by-case analysis. The CJEU did stress that it considered compulsory affiliation to a scheme to be both an inherent feature and a logical consequence of the solidarity principle (AEIP, ‘Reflection Paper on Solidarity in Social Protection’, June 2005). In *Kattner Stahlbau* the CJEU furthermore held:

(...) the principle of solidarity, which is characterised, in particular, by funding through contributions the amount of which is not strictly proportionate to the risks insured and by the granting of benefits the amount of which is not strictly proportionate to contributions. (87)

In *AG2R* the CJEU added that:

“That scheme does not, therefore, take into consideration factors such as age, state of health or any particular risks inherent in the position occupied by the insured employee.” (49)

Somewhat as an aside, it remains to be seen whether the Dutch Pension Accord¹³ will pass the – be it vague – solidarity test of the CJEU. The level of solidarity between generations is a controversial issue in the Accord (Kocken and van Wijnbergen, 2011). Also, the pension benefits are no longer secured (if they were ever). Fact is that optional insurance schemes operating according to the capitalisation principle, even where they are managed by non-profit organizations are considered as economic activities (*Fédération française des sociétés d'assurance and Others* case, 1995). The capitalization principle means that the insurance benefits depend solely on the amount of contributions paid by the recipients and the financial returns on the investments made.¹⁴ On the other hand, the management of compulsory insurance schemes pursuing an exclusively social objective, functioning according to the

¹³ See supra note 1.

¹⁴ SEC(2010) 1545.

principle of solidarity, offering insurance benefits independently of contributions have been classified as non-economic activities of a purely social nature (*Commission v. France*, 1997).

Van de Gronden and Sauter argue that in the *AG2R* case the CJEU extended the above described two-tiered test (exploring the role of solidarity and mapping the impact of the state supervisory mechanisms), towards bodies managing social security schemes (Van de Gronden and Sauter, 2011). Apart from being governed by the principle of solidarity, these bodies must be subject to a substantial degree of control by the state in order to escape from competition law. This implies that bodies operating in a public environment are more likely to be exempted from the competition rules than privatized bodies providing similar services.

Above it was demonstrated that it depends on the national design of the pension schemes whether managing bodies fall within the ambit of EU competition law (Van de Gronden, 2009). The main argument is related to the principle of solidarity and state control.¹⁵ However, a caveat must be added: the non-applicability of the competition law rules does not mean that the activities of the pension scheme/fund must not be in conformity with the four freedoms (goods, services, capital and persons). Van de Gronden points out that in this regard it is remarkable that in the cases *Freskot* (2003) and *Kattner Stahlbau*, where the CJEU progressively extended the scope the EU free movement regime to insurable risks, the principle of solidarity played a decisive role in applying the concept of undertaking to the managing bodies concerned (Van de Gronden, 2011). According to this author it is striking that the CJEU finally decided that the managing bodies concerned were not engaged in economic activities and that, therefore, competition law was not applicable, whereas at the same time it held that the free movement rules *did* apply. Consequently, these judgments show that scope of free movement is broader than the scope of competition law (Szyszczak, 2009). In the cited cases, the focus was on statutory social security schemes. So far, there is no case law regarding the question whether compulsory affiliation to *complementary* schemes might be in violation of Article 56 TFEU (free movement of services). With regard to pension schemes in the 2nd pillar, the IOPR-Directive, Article 20(1) leaves little room for misunderstanding:

Without prejudice to national social and labour legislation on the organisation of pension systems, including compulsory membership and the outcomes of collective

¹⁵Note that in health care case the universal coverage is of interest as well since providing access to all may be regarded as an expression of solidarity, as the ECJ did in the *FENIN* case, ECJ, Case C-205/03 *P FENIN v Commission* [2006] ECR I-6295.

bargaining agreements, Member States shall allow undertakings located within their territories to sponsor institutions for occupational retirement provision authorised in other Member States.

Furthermore, it should be borne in mind that the necessity, for a Member State to preserve the financial equilibrium of its retirement system constitutes a legitimate ground for restricting freedom of movement, as is made expressly clear in (old) Article 137(4) EC and the case-law (Opinion to case *Commission v. Czech Republic*, 2010; *Haackert* case, 2004). Moreover, the CJEU has accepted that the Member States have a wide discretion in the organisation of their retirement systems where that organisation involves complex evaluations of financial data (*Albany* case, 1999).

In general, however, the free movement rules are capable of breaking open social security schemes, whereas the role of competition law is limited in this respect (Van de Gronden 2011).

To conclude this paragraph, a point of criticism on the case law of the CJEU. It has been argued that that the CJEU in *Albany* failed to take the above described functional approach and logic far enough (Clark and Bennett, 2001). The CJEU seems to have assumed that pension funds are simply the representatives of beneficiaries' interests, ignoring the important financial institutions owned and operated by those funds. Moreover, the CJEU failed to appreciate the hidden costs of sector fund economic organizations - that is, the potential costs associated with the vertical integration of funds' financial services borne by pension fund beneficiaries, plan sponsors and/or participating employees(Clark and Bennett, 2011).

4. The IORP Directive

4.1 Preliminary remarks

First, it is important to note that there are three main categories of pension schemes in the EU Member States: social security schemes (first pillar), occupational schemes (second pillar) and individual schemes (third pillar). Occupational schemes generally involve employer and employees paying into a savings scheme, out of which retirement benefits will be paid to these same employees. IORPs can only operate on occupational schemes.

Second, there is a distinction between funded schemes and pay-as-you-go schemes

(PAYG). In a PAYG system, benefits are financed by current contributions. No capital is kept in reserve. In funded pension schemes a capital reserve is created during the accrual period. This reserve is used to fund future benefits.

Third, roughly speaking, *funded* pension schemes can either take the form of a Defined Benefit (DB) scheme or a Defined Contribution (DC) scheme.¹⁶ The Netherlands and the United Kingdom are the frontrunners in the EU where DB schemes are concerned. New EU Member States mostly operate DC schemes. The main difference between the two pension schemes lies in who bears the risks. In a DB scheme, the sponsor (usually the employer) bears the risk; in a DC scheme, the individual member (usually the employee) bears the risk. In other words, a member of a DB scheme is ‘guaranteed’ a certain pension benefit whereas, for a member of a DC scheme, the level of contributions, rather than the final benefit, is pre-defined. The difference between DB and DC scheme has implications for the supervision structure. Financial supervision of DC schemes can be less complex in structure as there is no real need for buffers and/or solidarity mechanisms. After all, in pure DC schemes, no pension promises are made to members; the risk lies with the members/employees.

Fourth, in 2003, the European legislature issued a Directive on the activities and supervision of institutions for occupational retirement provision (IORPs). Some key Articles of the Directive should be addressed.

The current scope of the Directive (Article 2) covers IORPs with legal personality and where the IORPs does not have legal personality, those authorised entities responsible for managing them and acting on their behalf. Article 6 of the Directive defines an IORP as:

“an institution, irrespective of its legal form, operating on a funded basis, established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity on the basis of an agreement or a contract agreed individually or collectively between the employer(s) and the employee(s) or their respective representatives or with self-employed persons, in compliance with the legislation of the home and host Member States, and which carries out activities directly arising therefrom”.

¹⁶ All manner of hybrid schemes are possible as well.

According to the Directive retirement benefits are benefits paid by reference to reaching, or the expectation of reaching, retirement or, where they are supplementary to those benefits and provided on an ancillary basis, in the form of payments on death, disability, or cessation of employment or in the form of support payments or services in case of sickness, indigence or death. In order to facilitate financial security in retirement, these benefits usually take the form of payments for life. They may also be payments made for a temporary period or as a lump sum.

The current Directive explicitly excludes:

- a) institutions managing social-security schemes which are covered by Regulation (EEC) No. 1408/71 (partly replaced by 883/2004) and Regulation (EEC) No. 574/722;
- b) institutions which are covered by Directive 85/611/EEC and Directive 73/239/EEC, Directive 93/22/EEC, Directive 2000/12/EC and Directive 2002/83/EC;
- c) institutions which operate on a PAYG basis;
- d) institutions where employees of the sponsoring undertakings have no legal rights to benefits and where the sponsoring undertaking can redeem the assets at any time and not necessarily meet its obligations for payment of retirement benefits;
- e) companies using book-reserve schemes with a view to paying out retirement benefits to their employees.

Article 3 of the Directive foresees the application of the Directive to the non-compulsory occupational retirement provision business of IORPs managing social-security schemes covered by Regulations (EEC) No. 1408/71 and (EEC) No. 574/72.

Article 4 allows Member States to choose to apply the provisions of Articles 9 to 16 and Articles 18 to 20 of the IORP Directive to the occupational retirement provision business of insurance undertakings.¹⁷ In that case, all assets and liabilities corresponding to this business will be ring-fenced, managed and organised separately from the other activities of the insurance undertakings, without any possibility of transfer.

¹⁷ Some Member States (e.g. France) have availed themselves of this option, others (including the Netherlands) have not (Dutch Parliamentary Documents II, 2004/05, 30 104, no. 3, p. 7). See also: Van Meerten and Starink, 2011.

The second paragraph of Article 5 provides the option for Member States not to apply Articles 9 to 17 to institutions where occupational retirement provision is made under statute, pursuant to legislation, and is guaranteed by a public authority.

According to the OPC Report on pension institutions outside the statutorily managed first pillar, (Commission working document accompanying the Green Paper, 2009: Table 1) pension schemes/institutions in the following member states are explicitly excluded from the scope of the IORP Directive:

- a) social-security schemes falling under Regulation 1408/71 and Regulation 574/72: BG, HU, IT, LI, LT, LV, NO, PL, RO, SK;
- b) covered by other EU Directives: AT, BE, CY, DE, DK, EE, ES, FR, HU, IE, IT, LT, LU, NL, NO, PT, PL, SE, UK;
- c) PAYG schemes: CY, FR, NO;
- d) institutions where employees of the sponsoring undertakings have no legal rights to benefits: DE, NO;
- e) book reserve schemes: AT, BE, CY, DE, IT, LU, NO, PT, SE.

Analysis of the current existing pension schemes/institutions and the applicable EU legislation (Commission working document accompanying the Green Paper, 2009: Table 1) has shown that there are pension schemes/institutions which fall outside the scope of any EU prudential legislation and the IORP Directive, although some member states apply the IORP Directive to these schemes/institutions on a voluntary basis. These schemes/institutions can be categorised as follows:

- a) voluntary personal pension plans in which the employer can make contributions: BG, CZ, HU;
- b) voluntary personal pension plans in which the employer cannot make contributions: MT, PT, SI, ES;
- c) mandatory personal pension plans in which the employer can make contributions: HU, IS;
- d) mandatory personal pension plans in which the employer cannot make contributions: HU.

4.2 Observations regarding the current scope

Pursuant to the Directive, activities of an IORP must be limited to activities in connection with retirement benefits and related activities. The definition of retirement benefits in the Directive for this purpose is a broad one. It includes labour-related retirement benefits in the form of payments during the entire remaining life, but also temporary benefits or lump sum benefits. Thus the definition of retirement benefits captures certain benefits that would not qualify as retirement benefits within the context of the Pension Act in the Netherlands (Explanatory Memorandum Dutch PPI Act, 2008-2009) Furthermore, this definition makes clear that an IORP cannot be an institution that operates on a ‘pay-as-you-go’ (hereinafter: PAYG) basis. This is explicitly confirmed by Article 2 paragraph 2(c) IORP. Furthermore, Member States are free to choose the legal form of an IORP.

All this leads to a situation where IORPs comprise almost all institutions that provide occupational retirement benefits, including pension funds, insurance companies and investment funds. Below it will be showed that the current regime is unclear and might introduce some perverse incentives.

First of all, the Member State option to apply the IORP Directive or the Solvency I and/or II Directive to the pensions business of insurers gives rise to competitive distortions (van Meerten and Starink, 2011). Insurers in some Member States can be subject to less strict capital requirements than insurers in other Member States. This has been an important source of tensions between the insurance and pension funds sector. The insurance sector is arguing for an extension of Solvency II-type rules to the IORP Directive, while the pension funds sector finds such rules inappropriate.

Second, the IORP Directive currently exempts PAYG schemes and book reserves from its scope. This results in an unequal application of the IORP Directive to what appears to be similar schemes. For example, both in Germany and the UK pension promises have to be backed by the plan sponsor and a protection fund is in place in case a company becomes insolvent. The IORP Directive allows German schemes to be largely unfunded by exempting book reserves, while UK schemes have to be fully funded as assets are set aside into a trust. Furthermore, most social pension schemes fall under the EU coordination system of social security. For example, this is the case of the French schemes AGIRC/ARRCO, which are entirely managed by the social partners and work on a PAYG basis; as well as the case for the Finnish statutory schemes ‘TEL’ which work on a mixed basis (partly PAYG and partly funded) and managed by private paritarian social protection entities. This is also the case for

the Swiss mandatory funded second pillar schemes, also managed by social partners and falling under the EU coordination rules (AEIP's reaction to the Green Paper, 2010). PAYG schemes are similar to many DB plans as pension commitments are supported by contributions paid by employers and employees. The IORP Directive allows the industry-wide schemes in France (AGIRC/ARRCO) to operate on a PAYG basis, while industry-wide pension schemes in the Netherlands or the United Kingdom have to be fully funded.

Third, the IORP Directive does not only allow insurance-type vehicles within its scope, but also some investment funds. Investment funds are generally 'empty' vehicles/contracts without, for instance, a governing board, established by financial institutions in which all risks are borne by the individual investor. Since schemes without legal personality can also qualify as IORPs (like in Malta, for example)¹⁸ the IORP vehicle is increasingly used for pension products that are directly marketed to retail investors. An important policy question is whether it is desirable that Member States have a choice to apply the IORP Directive or the UCITS Directive for such individual pension products. The IORP Directive may be misused to circumvent the restrictions on illiquid investments (private equity, infrastructure, real estate) included in the UCITS Directive to protect retail investors.

5. A new regulatory framework

A key question is which pension funds/schemes should be subject to the secondary EU-legislation framework, i.e. the IORP-Directive? As already said above, many Member States want to escape regulation by this Directive. Some because of the possible future solvency (II-alike) requirements. The United Kingdom, for example,

(...) supports the objectives of Solvency II for insurers. However, the application of a similar solvency regime for pension funds would raise funding requirements beyond those needed for financial stability and member security purposes. This would significantly raise the costs of Defined Benefit schemes to sponsoring employers, potentially reducing benefits for members of such schemes.¹⁹

¹⁸ In Malta, the retirement Scheme of a contractual nature consists of a separate pool of assets with no legal personality with the purpose of providing retirement benefits. See: Legal form of the IORP, CEIOPS-DOC-08-06 Rev1, 30 October 2009.

¹⁹ Supra, n. 5.

Other Member States argue more generally that their ‘pensions’ are ‘social’ products and therefore should not be subject to the Directive. For example, the German response to the Green Paper reads:

Der von der Kommission verfolgte Ansatz, mit einer Erweiterung des Anwendungsbereichs der IORP-Richtlinie den Binnenmarkt für Altersvorsorgeprodukte zu stärken, könnte damit nicht erreicht werden. Denn bei „book reserve schemes“ handelt es sich nicht um Finanzprodukte, sondern um unternehmensinterne Sozialleistungen, die in Deutschland über den Pensions-Sicherungs- Verein (PSV) gegen Verlust geschützt sind. Würde man an diese Leistungen aufsichtsrechtliche Vorgaben entsprechend der IORP-Richtlinie knüpfen, zum Beispiel im Hinblick auf eine Bedeckung mit Vermögenswerten, wäre das gleichbedeutend mit deren Abschaffung.²⁰

When redefining the scope, another important ‘defect’ in the Directive needs to be fixed.

In 2011, the foundation Holland Financial Centre performed a feasibility study of a tax-qualifying pension scheme for the Netherlands and the United Kingdom.²¹ One of the findings is that that so-called ‘pension pooling’ – i.e. operating pension schemes on a cross-border basis - is feasible, yet far from optimal. In practice, the requirement of respecting the national ‘social and labour’ encounters many obstacles (Article 20 IORP Directive:). Any IORP interested in carrying out cross-border activity is required to observe the social and labour laws of the Member State that qualifies as the home country of the pension scheme. As each Member State is free to interpret the provisions, this legislation ranges widely from country to country. At times, prudential supervision rules even form part of social and labour laws. This diffuses the distinction between ‘social and labour law’ on the one hand, and ‘prudential (financial) law’ on the other side. The Directive stipulates that ‘social and labour law’ applies to the scheme, and the prudential, financial law applies to the IORP.

A possible solution for the above addressed problems would be to replace the IORP

²⁰ Antworten der Bundesregierung auf die im Grünbuch enthaltenen Fragen der EU-Kommission - finale Fassung. Supra, n. 5. Author’s translation: “The Commission’s approach to widen the scope of the IORP Directive, in order to strengthen the internal market for pension products could thus not be achieved. “Book reserve schemes” are not financial products, but are about company intern social services, which are protected against loss in Germany by the Pension Protection Association. If one were to bring these services in accordance with regulatory requirements of the IORP Directive, for example in relation to the coverage of assets, that would be tantamount to the abolition.”

²¹ www.hollandfinancialcentre.nl.

Directive by two new regimes: a soft law code and a legislative approach (Article 288 TFEU). The soft law approach would ‘regulate’ certain non economic pension services of general interest; i.e. collective pension *schemes* established by employers or social partners *and* those *institutions* operating these schemes. These institutions/schemes would not be subject to the Directive as long as they meet a certain level of solidarity (e.g. the degree of absence of risk selection, average premiums height, degree of solidarity between generations, etc.). A European Communication or a code, explaining the main features of the pension schemes based on solidarity and the conditions they have to comply with in order to be exempted from the Directive and/or competition rules, could remove legal uncertainty (AIEP’s reaction to the Green Paper, 2010). To avoid free movement rules – if wanted- it could furthermore be prescribed that these institutions/schemes only operate domestically, meaning that they shall only operate schemes for beneficiaries with the nationality of the country where the fund has its seat.²² As is well known, in case there is no cross border element, EU law does – in principle - not apply.²³ An example can be found in the Solvency II Directive.²⁴ For these kind of schemes/funds – and strictly under the above described conditions - further harmonisation and a Solvency II-alike framework is not *per se* needed.

On the other hand, with regard to funds and schemes that do qualify as economic, the ‘whole nine yards’ must apply. These funds and schemes are active on the internal market and should be subject to competition law and the four freedoms. Here, more harmonisation is needed to reach a level playing field between IORPs and other financial institutions. The ‘hard law’ approach could follow the *Lamfalussy* technique²⁵ and could arrange for the same level of detail as the Solvency II regime (Lechkar, Nijenhuis, van Meerten, 2009), be it for IORPs with their own specifics. The legislation could regulate matters such as a qualitative (governance, financial reporting) and disclosure and information requirements.²⁶ The quantitative measures could be the (fixed) interest rate (Pikaart and Boss, 2011), the security

²² It remains uncertain under the IORP Directive when a fund is cross borderly active. Under the Dutch approach the difference between the location of establishment of the sponsoring undertaking and the location of the IORP is not decisive to determine the possible cross-border activity. What should decide is the difference between the ‘nationality’ of the pension scheme and the location of the IORP. See: Van Meerten 2009.

²³ In principle, because in practice a cross border element can easily be found.

²⁴ Article 304 of the Solvency II Directive, stipulates: “the activities of the undertaking related to points (a) and (b), in relation to which the approach referred to in this paragraph is applied, are pursued only in the Member State where the undertaking has been authorized.”

²⁵ With four levels of legislation. This method was introduced on the basis of the recommendations of the ‘Lamfalussy Report’ and accepted by the European Council: Resolution of 23 March 2001, OJ C138, 2001, 1/2. See for more detail: Ottow and Van Meerten 2010.

²⁶ For DC type plans the same information should be provided as for DB plans, except information on the funding level for those DC type plans where the members take the risk. See in this respect also: De Ryck, 1999, p. 50.

level (e.g. 97.5% or 99.5%, depending on the contract) the capital requirements (MCR/SCR)²⁷, technical provisions and – if necessary²⁸ - the buffers.

This construction, which clearly needs to be thought through and developed further, seems to have several advantages. The most important one is that the competences of the Member States in the field of pension social services are clearer defined and respected. Furthermore, a ‘race to the bottom’ between economic IORPs can be prevented: they all operate under the same conditions. Last but not least: the requirement of respecting national social and labour law can be *deleted*. In case of non-economic activity, the requirement is meaningless because there is no cross border activity. Funds only operate domestically and beneficiaries are always subject to national law. In case of economic activity, the protection of the participants is warranted through the EU harmonized ‘hard law’ regulation.²⁹ As was stated in the Solvency II Directive, the main objective of insurance and reinsurance regulation and supervision is the adequate protection of policy holders and beneficiaries (recital 16). This applies *mutatis mutandis* to pension regulation.

6. Conclusion

The European Union and EU law are highly important for the regulation of pension systems. A number of assumptions regarding the role of the European Union have been refuted in this contribution. The first assumption concerns the belief that pensions remain and should remain exclusively in the national sphere of competence. Indeed, the European Union lacks specific regulatory competences to regulate pensions, but when the adequate functioning of the Internal market is at stake the EU legislature may indeed adopt regulations or directives. The fact that many aspects of pensions touch upon e.g. the free movement of services, EU action may well be legitimate. The subsidiarity principle has proved no obstacle for EU action either. To the contrary, the fact that the Member states individually are less capable of regulating cross border aspects of pensions provides for a strong impetus for regulation at the EU level. Moreover, the subsidiarity principle excludes no areas up front from regulation at the EU level. This would be contrary to the dynamic nature of the principle which requires that the

²⁷ Minimum Capital Requirement and Solvency Capital Requirement.

²⁸ In case the fund operates DB-schemes.

²⁹ See Article 30 of the Solvency II Directive. Article 30(1 and 2) reads: “the financial supervision of insurance and reinsurance undertakings, including that of the business they pursue either through branches or under the freedom to provide services, shall be the sole responsibility of the home Member State. Financial supervision pursuant to paragraph 1 shall include verification, with respect to the entire business of the insurance and reinsurance undertaking, of its state of solvency, of the establishment of technical provisions, of its assets and of the eligible own funds, in accordance with the rules laid down or practices followed in the home Member State under provisions adopted at Community level.

particular circumstances in a certain field at a specific moment in time are taken into account. On the other hand, the subsidiarity principle may - more explicitly than in the past - require the added value of EU action to be established. The entry into force of the Lisbon Treaty has strengthened the subsidiarity principle to this end. National parliaments have now gained the power to scrutinize EU proposals on the basis of subsidiarity. The pensions dossiers is highly likely to become subject to this new scrutiny mechanism, but not to preserve national prerogatives but rather to achieve an appropriate mix of EU and national law taking into account both national and European interests.

Furthermore, the paper demonstrated that the EU regime is complex and inconsistent. As a result, the main piece of legislation, the IORP Directive, leads to distortions of the EU-level playing field. The paper has proposed a possible solution for the dilemma when regulating pensions: should it be a national or an EU competence? It is suggested that the regulation of pensions could be divided into a soft law approach and a hard law approach. Since social services, including pensions, can be of an economic or non-economic nature, depending on the activity under consideration, it is proposed to regulate the *economic* activities at the EU level, whereas the *non-economic* activities of pension funds can be regulated nationally. In this respect, the EU only can provide non-binding guidance.

To conclude, one cannot simply state that ‘pensions’ are a national or a EU competence. Each decision must be made on an *ad hoc* basis.

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