



Network for Studies on Pensions, Aging and Retirement

Netspar DESIGN PAPERS

*Ton van den Brink, Hans van Meerten and
Sybe de Vries*

Regulating pensions: Why the European Union matters





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Editorial Address

Netspar, Tilburg University

Postbus 90153, 5000 LE Tilburg, the Netherlands

info@netspar.nl

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PREFACE

Netspar stimulates debate and fundamental research in the field of pensions, aging and retirement. The aging of the population is front-page news, as many baby boomers are now moving into retirement. More generally, people live longer and in better health while at the same time families choose to have fewer children. Although the aging of the population often gets negative attention, with bleak pictures painted of the doubling of the ratio of the number of people aged 65 and older to the number of the working population during the next decades, it must, at the same time, be a boon to society that so many people are living longer and healthier lives. Can the falling number of working young afford to pay the pensions for a growing number of pensioners? Do people have to work a longer working week and postpone retirement? Or should the pensions be cut or the premiums paid by the working population be raised to afford social security for a growing group of pensioners? Should people be encouraged to take more responsibility for their own pension? What is the changing role of employers associations and trade unions in the organization of pensions? Can and are people prepared to undertake investment for their own pension, or are they happy to leave this to the pension funds? Who takes responsibility for the pension funds? How can a transparent and level playing field for pension funds and insurance companies be ensured? How should an acceptable trade-off be struck between social goals such as solidarity between young and old, or rich and poor, and individual freedom? But most important of all: how

can the benefits of living longer and healthier be harnessed for a happier and more prosperous society?

The Netspar Panel Papers aim to meet the demand for understanding the ever-expanding academic literature on the consequences of aging populations. They also aim to help give a better scientific underpinning of policy advice. They attempt to provide a survey of the latest and most relevant research, try to explain this in a non-technical manner and outline the implications for policy questions faced by Netspar's partners. Let there be no mistake. In many ways, formulating such a position paper is a tougher task than writing an academic paper or an op-ed piece. The authors have benefitted from the comments of the Editorial Board on various drafts and also from the discussions during the presentation of their paper at a Netspar Panel Meeting.

I hope the result helps reaching Netspar's aim to stimulate social innovation in addressing the challenges and opportunities raised by aging in an efficient and equitable manner and in an international setting.

Roel Beetsma

Chairman of the Netspar Editorial Board

Affiliations

Ton van den Brink: Utrecht University

Hans van Meerten: Clifford Chance LLP, Amsterdam

Sybe de Vries: Utrecht University

REGULATING PENSIONS: WHY THE EUROPEAN UNION MATTERS

Abstract

EU law is becoming increasingly relevant for pensions. In exploring the ways in which EU laws affect national pensions systems, this paper discusses the following: 1) the principle of subsidiarity and the division of powers between the EU and the Member States; 2) the concept of 'services of general economic interest' and; 3) the case law regarding the level of solidarity of a pension fund casu quo scheme. National policy-makers should take these concepts into account when designing national pension law and policy. The paper also focuses on some fundamental questions regarding the scope of the IORP Directive. This analysis sheds light on the highly complex world of EU Pensions, and demonstrates that the division of powers between the EU and the Member States regarding pensions is blurred and needs clarification.

1. Introduction

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

The pressure on pension systems is a problem confronting all Member States of the European Union. 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 featured pensions prominently on its policy agenda, most notably by its 2010 Green Paper entitled '*Towards Adequate, Sustainable and Safe European Pension Systems*' (hereafter, the *Green Paper*). In addition to addressing the ageing issue and the problems directly related to it,² the European Commission has also identified challenges presented by changes to pension systems,³ the impact of the financial and economic crisis,⁴ and removing obstacles to mobility in the EU. The Commission explicitly states, however, that Member States are

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. Should they therefore still be treated equally?

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

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.

responsible for pension provision, and that the Green Paper does not question either Member States' prerogatives in pensions or the role of social partners.

The Commission has initiated a public debate to consult all stakeholders about the challenges that have been identified.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 (Institutions for Occupational Retirement Provision; EIOPA, 2011).⁶

Since EU law has become increasingly relevant, this paper explores how some parts of EU law (see below) affect 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). The focus will also 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 can policymakers overcome certain political dilemmas when regulating pensions? Obtaining an overview of relevant EU law (see also the annex) and the answers to these questions may support national policymakers in drafting national measures regarding pensions.

The paper is structured as follows. Section 2 addresses the institutional framework regarding pensions. Key issues include the questions of 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. Section 3 explores how general EU policies

5 A website was launched especially for this purpose: ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=839&furtherNews=yes.

6 EIOPA's response appeared in October 2011.

(most notable among them EU competition law and the free movement of services) affect or may affect pension systems. Section 4 focuses on the existing IORP Directive. Section 5 argues that the current highly fragmented and complex regulatory EU framework regarding pensions should be clarified, and discusses how to achieve such clarification. Section 6 concludes.

2. The EU institutional regime regarding pensions

2.1 Introduction

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 effect have indeed impacted 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.

A first step toward answering the question above involves considering the constitutional system of EU competencies. In political circles, the issues of competencies and subsidiarity are often confused. This may have to do with the fact that both principles relate to the question of whether the European Union is allowed to regulate in a specific domain. The constitutional system of the EU separates competencies and subsidiarity, however, and puts them into consecutive order. Thus, if new legislation is considered at the EU level, it must first be established whether the EU is empowered (has the competency) to act in the field concerned. Only after this has been established and an appropriate legal basis has been found, does the subsidiarity principle come into play, requiring that an assessment be made whether the EU should indeed *exercise* such a power. The subsidiarity principle is, thus, a principle that governs the *exercise* of EU competencies rather than the establishment thereof.

⁷ See section 4.

2.2 Competencies in the field of pensions

The issue of competencies is an expression of the legality principle at the EU level (Prechal, 2010). The attribution principle plays a key role in this regard, 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 Court of Justice of the European Union (hereafter, *CJEU*) has determined, however, 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

“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 competition fall within the ambit of Article 114 TFEU. Already prior to this ruling, however, Van Ooik observed that it is hardly difficult to set up a line of reasoning arguing that differences in national legislation lead to inequalities in the market from which some may benefit and others suffer (Van Ooik, 1999).

The case upon which the above-mentioned ruling was based 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 magazines, for example, would ensure that free trade in such publications is not hindered. Without such an EU-wide ban, certain magazines might be marketed in some Member States, whereas in others they might not. Only for cases in which such a link with the internal market is totally absent would Article 114 TFEU be inappropriate. Following the CJEU's ruling, a new tobacco advertisement directive with a smaller scope was indeed adopted. Germany challenged this new directive as well – but this time the CJEU upheld it.

The IORP Directive was also (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 cases of overlapping powers (*Titanium Dioxide Directive* case, 1991). Notably, this case concerned a horizontal overlap of powers, concerning EU competencies 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 competencies are not being balanced in order 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 were put forward at the time of the adoption of the IORP Directive (see *infra*) that the Member States should retain 'full responsibility' for certain aspects of pension law would 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.

Of overriding importance is therefore the political willingness of the legislative institutions to engage in further steps in the development of EU pension law. It must be noted at this point that Article 114 TFEU requires only a qualified majority of the Member States to favor a proposal in order for it to be adopted.

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, acting on a proposal from the Commission and after consulting the European Parliament, to adopt guidelines that must be taken into account by Member States in their employment policies. Article 148(3 and 4) TFEU allows 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; HSG, 2011). Note 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 measure. This was confirmed by the CJEU (*Commission v. Czech Republic* case, 2010), and corroborates the prominent position of the internal market legal bases.

2.3 Subsidiarity

In order to justify the national competencies 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 also viewed from a political and economic perspective as well (Gelauf, 2008). This paper approaches the analysis by adopting the legal perspective on subsidiarity, 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,

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.

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 to which it is currently subject. In particular, the nature of the principle calls for further analysis. Neither the legal nor the political nature of the principle are sharply defined – even though the principle was introduced in 1992 by the Treaty of Maastricht. By some it was seen at the time as a threat to the European integration process. Toth described the introduction of the principle as a 'retrograde step', and predicted that 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 has also had 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 CJEU's approach has been different, however: in that the principle is essentially a political principle, the CJEU has 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, 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.

Inevitably, the subsidiarity principle has gained importance since 2009, when the Lisbon treaty entered into force. 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 scrutinise all EU legislative proposals. Selection is therefore 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 also – inherent in the possibility to initiate legal proceedings – individual power.

The adoption of the IORP Directive has given rise to a rather intense 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 argument fits the attribution/legal basis principle better than it does the subsidiarity principle. Indeed, the argument seems to be that two aspects (*i.e.* the organisation of pension system and the balancing of the three pillars) are *a priori* excluded from EU competence. Even at present, when the subsidiarity principle has only just started to take shape, it is clear that it is not suited to form an *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 pension law at the level of the European Union, the consequences are the following. First, the EU should take account of the possibility of a situation arising in which a majority of member states agree that further steps in this area are indeed necessary – even if that would affect the organisation of pension systems or the role of the ‘pillars’. A Member State that finds 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 on its side. This will not change – despite the fact that the EU legislature has clearly defined subsidiarity and identified the concrete effects thereof when the IORP Directive was adopted.

Second, rather than ensuring 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. This development, which has started to develop in other areas, will likely 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'. The subsidiarity principle will thus become a vehicle for evidence-based policy making.

3. EU substantive law and EU pensions

3.1 Introduction

As the provision of pensions constitutes an economic activity, pension provision will normally be considered as a service, in line with EU law. According to Article 57 TFEU, services are normally provided for remuneration. The Court has, for instance, recognised that healthcare constitutes a service within the meaning of this provision, whenever a patient moves to another Member State to pay for 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 inter-state trade. It is therefore important to bear in mind that apart from the legal regime established by the IORP Directive, the Treaty rules (primarily EU law) may apply – ultimately setting the limits of Member States' powers to regulate the field of pensions.

Pension funds must, through their activities on the market, respect not only Member State regulations but also 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 aimed at pension funds. The EU competition rules are specifically aimed 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, which thereby guarantee 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, which contains an exception ground for undertakings entrusted with the operation of SGEI, but which 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 authorisation scheme for investments in housing projects by housing corporations in other Member States. 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).

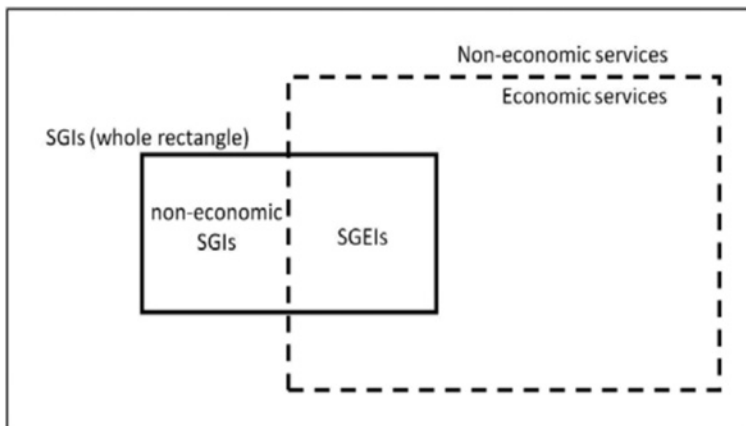
While Article 106(2) TFEU has played a vital role where Member States grant exclusive or special rights to undertakings for public service reasons, it is also relevant for other Treaty provisions as well – for example, Article 107 TFEU on state aid. If Member States grant financial aid to undertakings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

In the following period, 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 Treaty of Lisbon entering into force. 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), emphasise 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 themselves 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 that are subjected to specific service obligations by virtue of a general interest criterion (EC, 2003:6-7). But *services of general interest* (hereafter, *SGI*) cover market and non-market services. The protocol on SGIs attached to the Treaty mentions both SGEIs and SGIs. 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 organise *non-economic* services of general interest. This provision appears to be redundant, as these services would, after all, not be caught by the internal market rules in the first place.

The following diagram, devised 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 in 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 what is relevant is the type of activity performed (rather than the characteristics of the actors that perform the activity, the social objectives associated with it, or the regulatory or funding arrangements to which it is subject in a particular Member State), entails 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 that fulfil a social function and are subject to state control. This may be relevant for pension funds as well, as section 3.4 will show.

3.3 SGEI and the Treaty context: constitutional dimension

Treaty provisions relevant to SGEI

It should be noted right away that the core provision on services of general economic interest (i.e. Article 106(2) TFEU), was 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 constitutionalisation of the services of general economic interest” (Prechal, 2009:67). According to Article 16 EC, SGEIs 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 SGEIs 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 was 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 SGEIs 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 (Amténbrink and van de Gronden, 2008). It is assumed that it emphasizes the Member States' broad discretionary powers in this respect.

Third and finally, 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, commission and 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 the 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 the EU level – for example, with a view to modify the outcome of case law. Secondly, the fact that the provision enables the adoption only 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 SGEIs (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

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

3.4 The case law

The question of whether an activity is subject to EU internal market rules depends on whether the activities qualify as 'economic'.

First, note that services of pension funds may be of an economic or non-economic nature, depending on the activity under consideration.¹⁰ The fact that the activity in question is termed 'social' is not sufficient in itself (*Pavlov* case, 2000) for it to avoid being regarded as an 'economic activity' within the definition of the CJEU's case law.

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. (EC, 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 to a number of examples (EC, 2007). The CJEU ruled that a given entity may be engaged, on the one hand, in administrative activities that are not economic (such as police tasks), and on the other hand, in purely commercial activities (*Aéroports de Paris* case, 2003). An entity may also be engaged in non-economic activities in which it behaves like a charity fund and at the same time competes 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 activity must therefore be analyzed separately (*Commission v.*

¹⁰ 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'.

Italy case, 1987). It is, of course, as A.G. 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 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, then 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 (2nd pillar) scheme set up by a collective agreement concluded between organizations representing employers and workers in a given sector (affiliation to which was 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 vague, however, about the necessary level of solidarity of the scheme in order to justify the breach of competition law.¹¹

In its subsequent case law the CJEU did *not* develop universal solidarity criteria. Also here, determining the level of solidarity requires a case-by-case analysis.¹² 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, 2005).

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.

The discussion above demonstrated that the national design of the pension schemes determines 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.¹³ However, a caveat must be added: the non-appli-

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

12 See the extended version of this paper on www.netspar.nl and www.ssrn.com (nr. 1950765).

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

cability 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 of 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). Van de Gronden considered it to be remarkable 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 (2nd pillar) 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 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 organization of their retirement systems where that organization 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). Against this background, it seems premature to conclude whether or not the Dutch Pension Accord¹⁴ will pass the approval of CJEU if an 'Albany II' case would occur. There are too many vague, and sometimes even inconsistent, elements in the Court's reasoning regarding 'solidarity', and the Pension Accord itself is also a framework agreement.

14 See supra note 1.

4. The IORP Directive

4.1 Preliminary remarks

According to the IORP 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 the following:

- a) institutions managing social security schemes that are covered by Regulation (EEC) No. 1408/71 (partly replaced by 883/2004) and Regulation (EEC) No. 574/722;
- b) institutions that 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 that 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.¹⁵ 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.

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, (EC, 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 (EC 2009: Table 1) has shown that

¹⁵ 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.

there are pension schemes/institutions that 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 categorized 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 labor-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 stipulates that an IORP cannot be an institution that operates on a ‘pay-as-you-go’ (hereafter, 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 of this leads to a situation in which IORPs comprise almost all institutions that provide occupational retirement benefits,

including pension funds, insurance companies and investment funds. The discussion below shows 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 tension between the insurance and pension fund sectors. The insurance sector is arguing for an extension of Solvency II-type rules to the IORP Directive, while the pension fund 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. In both Germany and the UK, for example, pension promises have to be backed by the plan sponsor, and a protection fund is in place in case a company becomes insolvent. From the perspective of the pension beneficiary, in both cases the pension promise seems to be secured.

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 in a trust. Furthermore, most social pension schemes fall under the EU coordination system of social security. This is the case for both the French schemes AGIRC/ARRCO (which are entirely managed by the social partners and work on a PAYG basis), as well as the Finnish statutory schemes 'TEL' (which work on a mixed basis – partly PAYG and partly funded – and are managed by private paritarian social protection entities). The Swiss mandatory funded second-

pillar schemes operate similarly, and are also managed by social partners and fall under the EU coordination rules (AEIP, 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 is also applicable to schemes (without legal personality), as in the UK and Malta, for example.¹⁶ This might lead to confusion: is the IORP Directive applicable to the pension scheme or to the institution that operates the scheme? As the pension scheme is always governed by *local* social and labour law, and the institution by prudential law, these two legal frameworks can collide. A clearer distinction would be appropriate and might remove legal uncertainty in this respect.

¹⁶ 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.

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)? Some Member States want to escape regulation of the (revised) Directive. Some Member States argue that their 'pensions' are 'social' products and should therefore not be subject to an internal market Directive.¹⁷ Other Member States are concerned with the possible future solvency (II-alike) requirements and the so-called 'holistic balance sheet approach', which is a 'one size fits all IORP' approach. This could lead to more costly buffers and might require a pension fund to value sponsor contributions, which would, as EIOPA recognises, be a 'potentially complex and costly exercise for IORPS to undertake' (Call for Advice, p. 145).

A possible solution for the problems addressed above would involve replacing the IORP 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 met 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, drafted by the EC, explaining the main basic 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

¹⁷ *Supra*, n. 5.

remove legal uncertainty (AIEP, 2010). This non-binding code should have no direct legal consequences for the competences of the Member States to regulate national labor and social law. To avoid any ensnarement in free movement rules (if so desired), the code could further prescribe that these institutions/schemes only operate domestically, meaning that they shall only operate schemes with the 'nationality' of the country where the fund has its seat.¹⁸ As is well known, in cases where there is no cross border element, EU law does, in principle, not apply.¹⁹ An example can be found in the Solvency II Directive.²⁰ For these kind of schemes/funds (and strictly under the above-described conditions) further harmonization and a Solvency II-like framework is not *per se* needed.²¹

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 harmonization is needed to reach a level playing field between IORPs and other financial institutions. The 'hard law' approach

18 It remains uncertain under the IORP Directive when a fund is active cross-border. 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 be decisive is the difference between the 'nationality' of the pension scheme and the location of the IORP. See: Van Meerten 2009.

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

20 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."

21 The EC should also indicate when an activity is considered to be "cross border".

could follow the *Lamfalussy* technique,²² and could arrange for the same level of detail as the Solvency II regime (Lechkar, Nijenhuis, van Meerten, 2009), albeit for IORPs with their own specifics. The legislation could regulate matters such as qualitative requirements (governance, financial reporting) and disclosure and information requirements.²³ The quantitative measures could encompass the (fixed) interest rate (Pikaart and Boss, 2011), the security level (e.g. 97.5% or 99.5%, depending on the contract), the capital requirements (MCR/SCR)²⁴, technical provisions and, if necessary²⁵, the buffers.

This construction, which clearly needs to be thought through carefully and developed further, seems to have several advantages. The most important of these is that the competencies of the Member States in the field of pension social services would be more clearly defined and respected. Furthermore, a 'race to the bottom' between economic IORPs might thereby be prevented: they all operate under the same conditions. Last, but not least: the requirement of respecting national social and labor law could be *deleted*. In cases of non-economic activity, the requirement is meaningless because there is no cross border activity. These 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'

22 This method, which involves four levels of legislation, 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.

23 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.

24 Minimum Capital Requirement and Solvency Capital Requirement.

25 In case the fund operates DB schemes.

regulation.²⁶ 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.

²⁶ 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."

6. Conclusion

This paper provides a framework that can be used by policy-makers when drafting national legislation regarding pensions. It demonstrates that the European Union and EU (case) law are highly important for the regulation of national pension systems. A number of assumptions regarding the role of the EU 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 competencies to regulate pensions, but when the adequate functioning of the Internal Market is at stake the EU legislature may indeed adopt regulations or directives. Due to the fact that many aspects of pensions touch upon, for example, the free movement of services, EU action may well be legitimate. The subsidiarity principle has proved no obstacle for EU action, either.

The paper also addresses the highly important concept of SGEI. This is a crucial principle, since it co-determines both whether activities of pension funds can be classified as economic or not, and when breaches on the internal market are allowed.

The last section of this paper focuses on the IORP Directive and its revision. The paper shows that the current IORP Directive is unclear and leads to distortions of the internal market. A possible solution for the dilemma when regulating pensions is proposed: should it be a national or an EU competence? The suggestion was made 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, the paper proposes regulating the *economic* activities at the EU level, whereas the *non-economic* activities of pension funds can be

regulated nationally. In this respect, the EU can only provide non-binding guidance.

To conclude, it cannot simply be stated that 'pensions' are a national or an EU competence. Each decision must be made on an *ad hoc* basis. Neither can general conclusions be drawn as to whether the Pension Accord will be 'EU-proof'. The *ad hoc* approach of the CJEU is unpredictable, in this respect.

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Annex: Overview of Relevant EU law

Article Number	Explanation
Article 5(3) TEU	Principle of subsidiarity
Article 14 TEU	Legal basis for adoptions of Regulations to fund and commission services of general economic interest
Article 53 TFEU (ex 47 EC)	Legal basis for making regulations concerning self-employed persons
Article 56 TFEU	Freedom to provide services
Article 57 TFEU	Definition services
Article 62 TFEU (ex 55 EC)	Legal basis for making regulations concerning freedom to provide services.
Article 106(2) TFEU	Services of General Economic Interest
Article 107 TFEU	State aids
Article 114 TFEU	Legal basis harmonisation in Internal Market
Article 121 TFEU	Council may issue Draft guidelines on economic policies of the Member States
Article 126 TFEU	Procedure of monitoring budgetary discipline by the Council
Article 136 TFEU	Coordination by Council of Member States' budgetary discipline
Article 148 TFEU	OMC in field of employment
Article 153(4) TFEU (ex. 137(4) EC)	Financial equilibrium retirement system legitimate restriction ground of freedom of movement
Article 288 TFEU	Legal acts of the European Union
Article 2 Protocol no. 26	No effect of Treaties on competence of Member States to define non-economic services of general interest.

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Regulating pensions: Why the European Union matters

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