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THE LUXEMBOURG PENSION FUNDS & LIFE ASSURANCE POLICIES

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Introduction

The traditional pension systems are in jeopardy in many european countries. Fewer births and people living longer lives makes basic state pensions (pillar 1) too expensive. The emphasis for the future is put on Company Pension (pillar 2) as well as on individuals securing their own pensions (pillar 3). This issue has been adressed by the European Commission in the finally adopted Directive 2003/41/CE 13 May 2003 by the Counsil of Ministers on the activities and supervision of institutions for occupational pensions (EIORPs) which will speed the establishment of a harmonized European market for pension services.

Luxembourg in 1999 and 2000 anticipated the European directive by introducing its pension and insurance laws, becoming the most favorable location for the establishment of pension funds schemes. Its regulatory framework is characterized by flexiblity, safety and tax neutrality.

Two international pension saving vehicles are eligible; the Pension Saving Vehicle with Variable Capital (SEPCAV), the Pension Saving Association (ASSEP) and one domestic pension fund, the CAA Pension Fund. Another option is Single Premium Life Policies.

Luxembourg's International Pension Saving Vehicles

The Pension Saving Vehicle with Variable Capital (SEPCAV)

The applicable legislation is the law of June 8, 1999 as modified.

Supervision

The SEPCAV benefits from Luxembourg's experience within the Investment fund industry. It is under the supervision of the regulating authority for bank and investment funds, the Commission de Surveillance du Secteur Financier (CSSF). CSSF approval is required for directors, managers, asset managers and the scheme rule.

Legal Form

As the SICAV investment fund, the SEPCAV is close to a limited liability company where the value of the shares is equal to the value of shares at payment date multiplicated by their number. The beneficiaries own the shares, which the SEPCAV buys back from them at payment date in the form of a lump sum. A fund with compartments is possible. Each compartment has limited liability. It can be constituted with only one associate.

Contributions

The minimum share capital is of €1m, which has to be reached within 2 years. The shares are nominative and can't be sold or seized.

The Depository

The assets must be entrusted to a Luxembourg incorporated or established bank under the provision of the law from April 5, 1993. It will proceed the ordinary administration of the assets. The nomination and revocation of the depository is submitted to approval by the regulating authority

Asset Management

The management of the fund's assets can be delegated to one or more asset managers. The Luxembourg ones must be authorised under the provision of the law from April 5. Foreign asset managers must obtain the CSSF approval. The nomination and revocation of the depository is submitted to approval by the regulating authority

Contribution System

SEPCAV can only be used with a defined contribution plan.

Payment of Benefits

The beneficiaries are paid a lump sum through repurchase of shares.

Reporting rules

An annual and a semestrial report must be issued by the fund. A list with names of the shareholders, accumulated rights or repurchased shares must be established by the SEPCAV.

Investment policy

There are no restrictions.

Tax Regime

Being in limited liability form, the SEPCAV is fully subject to tax but benefits from exemptions. Income and capital gains from transferable securities are exempted from tax. Paid out benefits should be subject to taxation in the country of residence from the beneficiary. Double tax treaties should be applicable. There is no value-added tax on management fees as the SEPCAV is exempted from net worth tax. The SEPCAV is liable to a fixed capital duty of €1240.

The Pension Saving Association (ASSEP)

Supervision

Prudential control of the regulating authority for bank and investment funds, the Commission de Surveillance du Secteur Financier (CSSF).

Legal Form

the ASSEP has an associative structure similar to the non-for profit association (association sans but lucratif) created by the law of April 21, 1928. Several compartments with limited liability each are possible.

Contributions

the ASSEP has to create technical provisions of at least €5m. This minimum must be reached within 10 years. Technical provisions constituted for present and future benefits, must at any time be covered by the assets of the ASSEP eventually diminished by debts.

The Depository

Assets must be entrusted to a Luxembourg incorporated or established bank.

The Asset Management

the management of the fund's assets can be delegated to one or more asset managers. The Luxembourg asset managers must be authorised under the provision of the law from April 5, 1993 whereas foreign asset managers must obtain the CSSF approval.

The Liability Management

The ASSEP can delegate the management of its liabilities to a liability manager. The liability manager must be authorised by the CSSF or by the CAA and will establish a financing plan.

Defined Contributions and Benefits:

The ASSEP can be used for both the Defined Contribution and the Defined Benefit schemes.

Payment of Benefits

They can be paid in form of a lump sum or an annuity. Payments for complementary benefits like death in service, disability pensions as well as payments for widows and orphans are also possible.

Reporting Rules

An annual and a semestrial report must be issued by the fund. The ASSEP must hold a list of beneficiaries and the amount of their accumulated rights.

Investment Policy

No restrictions provided by the law which provides only for the "prudent man principle" and risk repartition. But legislation may be introduced to provide rules for investment.

Tax Regime

The ASSEP is subject to tax but profits give rise to tax deductible provisions. Paid out benefits should be subject to taxation in the country of residence from the beneficiary. Double tax treaties should be applicable. There is no value-added tax on management fees and the ASSEP is exempted from net worth tax. The ASSEP is liable to a fixed capital duty of 1240.

CAA Pension Fund

Supervision

the supervisory body is the Luxembourg Insurance Authority the “Commissariat aux Assurance”.

Legal Form

The fund can have a corporate or a contractual form. In can be set up as a mutual insurance association, a cooperative company, an incorporated cooperative company or as a non profit making association. The central administration is necessarily situated in Luxembourg.

Contributions

There are no minimum requirements. Assets must at any moment cover technical provisions and obligations towards the beneficiaries.

Depository

The pension fund’s assets can be put in custody in another EU member state.

The Asset Management

The CAA pension fund may delegate management of the funds assets to a Luxembourg located manager approved by the Treasury Minister (Ministre du Trésor).

Contribution System

The financing can be done by defined contributions, defined benefits plans or supplementary benefits for death or disability of members.

Payment of Benefits

Lump sum benefit or annuity.

Investment Policy

Defined quantitative limits in order to guarantee the security, profitability and liquidity of the investments. The principles are diversification and dispersion of the assets dedicates

to cover the technical provisions. More flexible conditions can be negotiated with the supervision authority.

Tax Regime

The CAA Pension Fund is submitted to tax. Profits give rise to allowable provisions. No Vat is charged on management fees. Double-tax treaties should be applicable.

The Perspectives under the New EIORPS Directive

The Council of the European Union has finally adopted the Directive 2003/41/CE on the activities and supervision of institutions of occupational retirement provisions (EIORPs) on the 13th of May 2003. Put forward by the European Commission in October 2000, the Council agreed on the text at second reading by the European Parliament. This directive represents a key element of the Commission's Financial Services Action Plan and is due to be implemented within 24 month after its publication in the EU's Official Journal (not publicised at issuing date) towards the end of 2005.

The Directive will provides a coherent framework for pensions fund's to work within the internal market. Efficient Pan-European pension funds will become possible.

The Directive is applicable to all institutions for occupational retirement provisions established on the territory of a European member state over a certain size.

Rules of Operation of the Institutions for Occupational Retirement

- Legal separation between the sponsoring undertaking and the institution.
- Proper information of the members and beneficiaries of the terms of the scheme, their individual rights and obligations as well as the financial risks.
- A prudent calculation of the future benefits of the beneficiaries is required. Sufficient assets must cover the liabilities.
- Member states will be required to give supervisory authorities all the necessary powers to monitor and supervise adequately the EIORPs. Exhaustive information is to be given to the authorities.

- Member states must authorise the professional retirement institutions to work with asset managers and depositories from other member states.
- Investment strategies; Assets must be invested according to the “prudent person principle”, fairly wide spread at all times in the best interest of the members, to ensure security, quality, liquidity and profitability of the portfolio. Set up Investment rules should be rather qualitative than quantitative.
- Investment in shares and risk capital should not be unduly restricted. Member states can provide for more detailed investment rules within their jurisdiction but they should not prevent institutions from investing up to 70% of their technical provisions or portfolio in shares and corporate bonds and up to 30% in currencies other than the currency of their future pension liabilities.

The Pan-European Institution for Professional Retirement

A pan-European pension fund is a pension fund established in a member-state of the European Union (home member state) which runs several retirement pensions plans in various companies established in different countries of the European Union (host member state) but belonging to the same group.

Pan-European pension funds must obtain approval in their “home” member state before offering their services in a host member-state.

Information is then exchanged between the home and the host member-state which will indicate to the pension fund the social and labour legislation concerning occupational pensions, which will be applicable in the host country.

Host-state authorities will control the application of their social and labour legislation and in case of violation ask the home Member State to stop such violations.

Host Member States can ask “home Member States to apply certain quantitative rules to asset held by cross-border pension schemes, provided the “host” Member State concerned applies the same rules (or stricter rules) to its own domestic fund. Quantitative rules concern only investment in asset not admitted to trading on a regulated market, assets issued by the sponsoring company and assets denominated in currencies other than those in which the scheme’s liabilities are expressed.

Luxembourg seems to be the ideal place to create Pan-European pension funds. It benefits from its know-how and reputation with common investment funds. The second advantage being Luxembourg's network of double taxation treaties. The two international pension funds SEPCAV and ASSEP, created by the law June 8, 1999 and the CAA pension fund created by the Règlement Grand-Ducal August 31, 2000 allow an unproblematic transposition of the EIORPs Directive.

Single Premium Policies

Another form of saving, often with a tax advantage, are the single premium savings schemes with Luxembourg insurance companies.

Typically the single premium might be for €2 million or more and would be contracted for around 10 years.

From a tax angle once the premium is paid, the monies for the period of the contract no longer belong to the estate of the person paying the premium and therefore, generally, cannot be declared for tax purposes.

The beneficiaries of the policy, will eventually be taxed according to the rules of the country in which they are resident. This is often far less than would have been the case.

Services in relation to Pension Funds and Single Premium Insurance policies.

Since their creation in 1999 and 2000 Luxembourg's Pension Fund laws have been much discussed in anticipation of the expected enactment of the relevant European Directive.

Hoogewerf & Cie have followed developments closely and have attended and spoken at conferences on the subject. Whilst Luxembourg has at 2003 had few examples of Pension Funds being set up, the process is expected to speed up. Hoogewerf & Cie are able to analyse client needs and provide an independent strategic approach.

Who to Contact at OCRA Luxembourg

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