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How to govern transnational pension provision? The struggle over the “prudent person standard” in EU pension fund regulation

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1. Introduction

This paper explores the conflictual development of EU-wide standards for the investment and supervision of occupational pension funds.[1] These arrangements became a field of growing social and academic concern in the past. On the one hand, their "financial security" gained considerable attention in the context of "pension crisis" and reform. Therein private pension funds are discussed as a substitute for diminished benefits from public PAYGO schemes. As Laboul/Yermo put it, "[a]llowing people to adjust through private pension saving also requires reforms to ensure that the operation of the financial sector inspires confidence in the safety and soundness of such saving" (Laboul and Yermo 2006: 502). On the other hand, pension funds are frequently discussed with regard to their role in finance. In the view of the OECD,

> [p]ension funds are one of the most important players in the financial markets of the OECD countries, managing more than $15 trillion of assets in 2003, which represents over 80 percent of the OECD's area GDP. Pension funds also play a key social role in channelling retirement contributions to finance retirement benefits. The investment of pension assets is one of the core functions performed by private pension arrangements (OECD 2006: 2).

Apart from the OECD as the most active *international* standard-setter[2], also the EU developed norms and regulatory structures in the realm of privately funded pension provision. Those are intimately connected to the "directive on the activities and supervision of institutions for occupational retirement provision"[3], frequently shortened to "pension fund" or "supplementary pensions" directive, adopted in 2003. It regulates the cross-border management of occupational pension funds in the internal market, the set-up and supervision of pan-European pension schemes as well as the investment and oversight of pension funds according to the standard of "prudent investment". As a priority in the Financial Service Action Plan of 1999 (itself a priority of the Lisbon Agenda), the directive not only aims at integrating European financial markets in this segment. In the view of one of its greatest promoters, this step towards a common EU framework for pension fund regulation also serves three other aims:

[1] Pension funds are understood as retirement arrangements linked to employment and accumulating financial assets for paying retirement benefits. They thus differ institutionally from public PAYGO pension schemes and private, individual old-age saving.

[2] Among other activities, the OECD defined "guidelines for pension fund governance" in 2002, "core principles of occupational pension regulation" in 2004 and "guidelines for pension fund asset management" in 2006.

[3] Directive 2003/41/EC, 3. June 2003, OJ 23.09.2003 (L 235/10-21)

> Clearly, we want security of pensions, this is so obvious it almost goes without say; What is less obvious, and sometimes not given enough prominence, is the affordability of these pensions. A secure pension fund that is unaffordable for the majority of workers or gives too small a pension in relation to the contributions is as bad news as lack of security. And finally, by having common prudential standards, we can also permit cross-border Membership (Bolkestein 2001) .

This piece of regulation has been analysed and discussed predominantly from financial economic and legal viewpoints in the past, i.e. with regard to its effectiveness in achieving those aims (e.g. Davis 2003, Hanlon 2003). Yet, recent studies focused more on the politics of European regulations in the field. These contributions particularly highlight the contested nature of regulating the investment and supervision of occupational pension provision at the EU-level. One of the major conflictual issues revolved thereby around the introduction of the "prudent investment principle", which is usually associated with a market-based approach to fund management and supervision. Thus Haverland (2004, 2006) identifies a conflict between the EU as a "regulatory state" and European (national) welfare states, which would fiercely protect their prerogative in pension policy-making in this realm. Looking rather at the policies involved in the policy-making process, Connell (2006) regards regulation in this realm as being driven by what he calls a "market order of worth". However, also this author remains sceptical about its success. These conclusions derive primarily from the achieved compromise regarding prudential rules for management and investment, as the final directive implemented the prudent person principle, yet also allowed for the setting of restrictions when considered necessary.

What is given less weight in these accounts is the socio-economic content of prudential rules. The "prudent person standard" as the main issue of conflict is frequently discussed as a genuinely Anglo-Saxon approach to pension management and investment (Clark 2004, Galer n/a, Vittas 1998). Pension fund management and investment in turn are thereby intimately connected with what Clark (2000) and other scholars writing from a political economy perspective called Anglo-American "pension fund capitalism", denoting a finance/welfare complex based to a large extend on privately funded pension provision and the crucial societal role of the financial industry. In this context, "prudent investment" by pension funds appears as a crucial normative (legal and ideological) feature of the markets, social institutions and state regulations of the Anglo-American pension system. This often corresponds with drawing a dividing line between the Anglo-Saxon institutions of "pension fund capitalism" and continental Europe, with its relatively low profile of funded pension provision, a larger share

of public pensions in retirement income and different financial regulations in this respect. According to Clark, thus, "[p]ension fund capitalism is very much an Anglo-American phenomenon" (Clark 2000: 66).

This begs the questions, why and how an "Anglo-Saxon approach" is introduced in EU pension fund regulation? What are the concrete points of contestation and in which way are these conflicts mediated? Exploring into this question may provide a different perspective on the "politics of the market" as it lies across the commonly drawn cleavages between as "single market vs. national control" or "market vs. social policy objectives" in the realm of pension fund regulation. The paper is divided in three parts. The first section introduces into the debate on the "prudent person standard", which primarily refers to Anglo-American pension fund institutions. Subsequently, a historical narrative of the politics of prudential regulations for pension schemes in the EU follows, whereas the last section concludes.

2. Features and development of the prudent person approach

The prudent person standard for pension fund management and investment is usually discussed with regard to Anglo-American trust law, ruling these functions according to fiduciary duties. The trust institution provides the legal structure of most private pension funds in the U.S. and U.K. (see e.g. Clark 2004).[4] Trust law states that "[a] fiduciary must discharge his or her duties with the care, skill, prudence and diligence that a prudent person acting in a like capacity would use in the conduct of an enterprise of like character and aims" (Galer n/a: 3). In contrast to what is often labelled a "draconian regime" of fund regulation, where outcome measures and quantitative rules apply, the prudent person standard thus prescribes managerial behaviour through qualitative rules. Judging this behaviour, i.e. by regulators, follows thereby not a retro perspective on successful management and investment, but implies the question whether fiduciaries, thus those in charge of managing and investing the fund, followed a "reasonable process in reaching their decisions" (ibid.).

However, due to the behavioural approach of the principle, social and political debates are fought over the question, what "reasonable behaviour" actually means and who should decide over its content. For most commentaries, this vagueness of the prudent-person rule is discussed as one its major advantages, as trustees and investment managers could steer the fund according to changing economic conditions and thereby secure the fund`s profitability

[4] Pension trusts define a pension sponsor (usually the company) making contributions to a pension scheme managed by trustees, who have to manage the fund in the sole interest of a beneficiaries (workers, pensioners).

and safety. Yet, whereas critics agree that the rule implies an empowerment of the financial industry, they underline, for instance, the herd behaviour of the latter in the investment process and the crucial fact that managing idiosyncratic risks does not abolish systemic risks in financial markets (Clark 2006, Vittas 1998). Referring to the US legal requirements of "expertise" and "prudence" in pension fund management, Ghilarducci observes that these concepts "are whatever passes for standard practice by members of the pension fund industry." Thus US law and supervisory authorities require "the industry to abide by the standards the industry itself defines" (Ghilarducci, cit. in Blackburn 2003: 129). However, these standards itself are not fixed, but reflect the perspective elaborated in the "pension fund capitalism" literature that the latter has to be understood in process rather than static terms. Despite the related and frequent characterisation of the prudent person principle as a genuinely "market-based" approach to management and supervision, this interpretation appears indeed as a relatively current one. In fact, fund managers and regulators understood it historically rather as a restrictive rule constraining investment freedom. Looking at the U.K., Galer notes that

> "The old English rule, which was designed to protect beneficiaries from speculative investments, provided that the sole obligation of a trustee was the conservation of principal and, therefore, that the only safe (and thus only prudent) investment was in government-backed securities" (Galer n/a: 8).

This fundamentally changed in the course of the 20th century and in particular since the 1970s and 80s, when existing regulations constraining investment were (partly) abolished, often accompanied by pressures of fund managers aiming at investment in high-return, yet also more risky assets (ibid.: 19). Since then, the concept underwent further re-interpretation. Whereas in earlier periods it was considered prudent to exercise pressure on corporations by selling their shares, the standard now shifts to actively engage in corporate governance and invest in alternative assets such as derivatives or private equity. According to a more recent account of the prudent person standard, its content and application by fund managers and regulators changed thereby considerably towards the marketisation of the investment process:

> [R]ules are often accompanied by an *implicit or explicit presumption that diversification of investments is a key indicator of prudence* in this sense. The prudent person rule, in effect, allows the free market to operate throughout the investment process while ensuing, along with solvency regulations, that there is both adequacy of assets and appropriate levels of risk. Rather than the focus being on the external rules, the onus is rather on internal controls and governance structures in which the authorities may have confidence. The authorities correspondingly require information on these aspects rather than purely

> focusing on the composition of the asset portfolio as is feasible with quantitative restrictions (Davis 2001: 24)

According to a member of the OECD financial market unit, the last point refers to one of the most controversial debates in pension fund regulation, because its outcome would determine "who – the state or the pension fund's governing body – will be responsible for establishing the initial asset allocation parameters for pension investment activity" and it would be here where the "long-run investment performance" is primarily determined (Galer n/a: 2). For many within the pension fund industry and related organisations, the answer to this question appears crystal clear. In response to the frequent claim to use pension capital for public policy or social purposes at that time (so called targeted investment), the president of the British National Association of Pension Funds (NAPF) argued in 1987:

> "The defined purpose of a pension fund is to provide an ultimate benefit to the member [...]. That is the ethical and social background to pension fund investment. It calls for professionalism of a high order and for absolute integrity under trust law and within the statutes of our society. The economic influence represented by the £200 billion (and rising) of investment potential is a significant factor in the activities of the City and of British industry. It is important, therefore, that the disciplines, strictly and necessarily observed by investment managers, should be fully understood" (James 1987: xi).

In the light of the pension fund capitalism literature, stating the dependence of pension security to the performance of financial managers and markets, we may thus conclude that prudential rules provide not at least the normative framework for linking "long-run investment performance", so prominent in OECD accounts, with pension security.

Against this background, the next section attempts to show that the content of this vaguely defined, yet thereby the more controversial standard refers to concrete social processes, struggle and regulatory projects. Whereas the debate on pension fund regulation and prudent investment standards has been led for long with reference to the Anglo-American context only, the following section also shows that it developed a particular drive within the context of EU financial market integration.

3. The *prudent person standard* as a European regulatory framework? The struggle over the "pension fund directive" revisited

This section provides an account of the development of pension fund regulation at the EU level, thereby focusing on the struggle over the "pension fund directive", in which the introduction of management and supervisory standards inspired by the prudent person approach represented one of the major conflictual issues.[5]

3.1 EU financial market integration and the liberalisation of pension fund regulation

Although pension fund regulation appears as a rather current issue, the European debate on this topic can be traced back to the 1970s. It has been primarily led in the context of developing risk capital markets at first. Already before the global recession of the 1970s, risk capital firms lobbied for market liberalisation and a pan-European risk capital market, yet, with little success. However, since then, Commission officials showed a stronger interest in such a project and organised several conferences with banks and risk capital firms. Their results are summarised by Weber/Posner as following:

> Reports from these meetings endorsed the idea of creating new markets to trade equities in startups, and suggested that governments ease restrictions on pension funds and insurance companies so that these large institutional investors could place more of their assets in such risky (but potentially high return) investments (Weber and Posner 2001: 155).

In the aftermath, the commission founded a working group for this issue area, together with risk capital firms and banks, which later gave rise to the establishment of the European Venture Capitalist Association (EVCA) – consequently called a "joint initiative of the industry and European Commission" (Business Week 1983, cit. in ibid.). Weber/Posner identify several reasons for the increasing interest in risk capital development in Europe. Whereas European banks tended to favour long-term and risk-averse investment relationships, the technology and start-up sector developed rapidly in the US, not at least due to the investment of pension funds. As a result, even many European firms in this sector started to seek access to U.S. capital, whereas U.S. fund managers already began to invest in Europe. This drove European initiatives to unlock the "conservatively" invested capital of European

[5] This section partly draws on Möllmann (forthcoming).

pension and investment funds. Diverse and rather restrictive investment regulations dominated here and institutional investors usually put their funds in corporate or government bonds as well as property. Moreover, investment in riskier assets such as equity or foreign currencies was limited by tax law, accounting rules and not at least quantitative investment restrictions, prescribing maximum limits for such asset classes. These rules targeted not only at investment risk reduction, but also allowed for stable demand for government bonds and domestic currency titles by domestic funds (Weber and Posner 2001: 153ff.). However, according to Weber/Posner, attempts of the Commission and European financial actors to liberalise this market were not only confronted with different and restrictive legislations, but also with the political content of these efforts – old age security: "Political sensitivities surrounding this issue remained extreme and the consensus in Europe was that reform would be gradual" (ibid.: 161).

In the context of the single market completion launched in 1986 and the earlier envisaged project of creating a single market for financial services,[6] first regulatory attempts in the pension fund sector started at the end of the 1980s. In 1989, British Commissioner Brittan (GD Internal Market and Financial Services) claimed that a single market in financial services would not be complete without the involvement of pension funds, which would already account for one third of all stocks traded in the London stock exchange at that time (Brunet and d´Yvoire 1999: 10). A first draft directive on the "freedom of management and investment of funds held by institutions for retirement provision"[7] was issued a year later. In the view of the Commission, those institutions would not only represent important capital saving schemes, but also supplementary sources of retirement income. The proposal comprised the free choice of pension fund managers in the internal market and the prohibition of investment restrictions. Rather, funds should be solely managed according to the requirements of security, quality, liquidity and return chances. Also maximum limits for foreign investment were tackled by the draft directive (see articles 3, 4). Strong support for the proposal came from the European Federation for Retirement Provision (EFRP), founded in 1981 by British pension fund managers and organising the industry at the EU level. It opted for a full abolishment of investment restrictions, as those would prevent higher returns possible. Yet, at the same time it received also strong opposition from the insurance industry group Comité Européen de l´Assurance (CEA), which argued that the insurance directive already in place provided much higher security for pensioners and could also prevent

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[6] See Story/Walter (1997) for an account of this project.

[7] COM(91)301 final

competition distortions deriving from liberal pension investment regimes. Hence, insurance regulation should also be applied to the pension sector (Brunet and d´Yvoire 1999: 11).
This conflict over investment standards continued in the Council. According to Brunet/d`Yvoire, the draft directive led to a clash between countries with strong pension fund sector and prudent person regulations (UK, Netherlands, Ireland) and those with a strong insurance sector and quantitative rules such as France and Germany. Points of contestation involved thereby the financing of government debt through insurance undertakings, the backing of the domestic currency and competition between financial centres (ibid.). Due to the apparent tendency in the Council to legitimise rather than to liberalise existing regulations, the Commission withdraw its proposal in 1993, but issued a communication shortly afterwards with the same content (European Commission 1997: 14). As a consequence, France sued the Commission on the ground that the latter could not introduce norms via a communication, rejected by the Council before.[8] The European Court of Justice followed this argument, yet, it also dismissed the second point put forward by France, the communication`s content would imply unequal competition for insurance companies in the single market (see also Brunet/d`Yvoire 1999: 11).

3.2 From market liberalisation to formulating common regulatory standards

After the defeat of the directive, respectively its particular socio-economic content, a new approach to regulating pension funds at the EU-level took shape. It implied, on the one hand, the linkage of retirement investment regulation to the new discoursive "heavy weight" of ageing societies and public pension reform.[9] Moreover, it shifted the regulatory focus from *liberalisation* to the *supervision* of occupational pension arrangements in the internal market.
The first of these two aspect, pension security, appeared in official Commission documents in 1995 for the first time and led to a Communication on the "modernisation and improvement of social security" (Europäische Kommission 1995, 1997). Therein it is stated that the ageing of European societies implies serious threats to public pension systems, leading to discussions on alternatives and stabilising measures. The main task would be to secure the financial viability of public pension accounts, while at the same time to achieve an overall sufficient retirement income level. Changing prudential rules for pension fund management,

[8] C-57/95 France vs. Commission
[9] Note that the much referred „starting point" for this discourse on a global scale, the World Bank report „Averting the old-age crisis", was published in 1994.

occupational pension arrangements, so the argument goes, could provide a secure and efficient supplementary source of income for retirees and additionally reap the fruits of the internal market. This line of reasoning also shapes the green book of 1997 on supplementary pensions in the single market, which sees the security and efficiency of these institutions as one of the main reason for regulatory action in this field, next to the development of capital markets and the aspect of labour mobility linked to occupational pension schemes. So the document asks how higher returns could be achieved without excessive risks and underlines the superiority of a prudent instead of a quantitative investment standards:

> "The Commission believes that in many cases they go beyond what is objectively necessary to maintain adequate prudential supervision. There are other prudential rules and techniques that are consistent with a Single Market and maintain equivalent prudential security. In particular, Member States' prudential rules relating to investment portfolios can have the effect of obliging pension and life insurance funds to invest a large proportion of their assets in domestic government bonds" (European Commission 1997b: 10).

Moreover, financing retirement income through state bonds would increasingly contradict the reduction of state debt within the EMU and hinder pension funds to profit from higher returns possible by equity investment. Consequently, the content of the withdrawn directive and the communication are re-considered in the green book. But now those would have to be considered "in a broader context: in fact all the more so in view of the increasing awareness of the need to reform pension systems with a view to ensuring their sustainability" (ibid.: 11). Whereas investment freedom is thereby linked to the objective of higher returns, the "prudent investment rule" is emphasised as a means to secure the fund from investment risk.

The last aspect points to the second shift in the politics of regulation. Whereas former attempts to implement common norms targeted on the liberalisation of investment rules and the freedom of cross-border management, now the harmonisation of prudential regulations and supervisory regimes moved stronger into the forefront. Internal market Commissioner Monti explained this new strategy with reference to the answers to green book, which can be seen as a means to "test" the relevance of the themes and issues it raised (Pochet 2003: 51):

> "The vast majority of interested parties who responded to the Green Paper called for an EU approach based on safeguards to ensure pension fund managers adopt a prudent and diversified investment policy based on maximum freedom of investment rather than quantitative investment restrictions. I will therefore be recommending that the Commission proposes a Directive to establish an appropriate framework of prudential rules that sets minimum investment safeguards and tackles quantitative

> restrictions […]. [S]uch an approach will ensure funded supplementary pensions can offer workers and their families higher levels of security (notably through investment diversification) combined with optimum returns" (Europäische Kommission 1998a).

The new focus on prudential regulations and their linkage to "pension security" may root not at least in the insight that the neglect of this issues led to the failing of former regulatory attempts. Bolkestein, Monti`s successor in the GD internal market, declared that „[f]ormer Commission initiatives in this area have been perceived as excessively focused on investment and management liberalisation. There is now a common understanding between all parties that security must come first" (Bolkestein 2000). Apart from that, the former separation of the financial dimension of pension funds from their national regulation and supervision has been detected as another major reason for the opposition to liberalisation. According to John Mogg, director in the GD internal market „[p]ast Commission proposals in the field of supplementary pensions failed partly, because the Commission concentrated exclusively on investment and management rules, leaving prudential issues to Member States. This time, we will tackle investment and prudential rules together" (Mogg 1999: 5). But the answers to the green book showed also a wide-ranging divergence of ideas in the realm of supervisory standards. In general, the conviction was shared that the principle of "prudent investment" should govern the supervision and management of pension funds. Yet, interpretations of what this actually implies differed a lot. Whereas many answers to the green book saw wide-ranging freedom of fund managers as its basic content, because this could provide the freedom necessary to adjust investment of assets to the liabilities of the pension scheme, others underlined that some quantitative rules remain necessary for diversifying risk (Europäische Kommission 1998b: 6). Another debate concerned the concrete impact of prudential rules on the practice of fund management and investment. Whereas many commentaries saw a direct link between investment practice and regulations and referred to the import of the psychological limits in the management and investment, others stressed that investment in certain asset classes such as equity often remained below the quantitative restrictions. Rather, the management of pension funds would depend on different "financial cultures" within Europe (ibid.: 20f.).

Different „cultures" in governing supplementary pension schemes led to subsequent efforts in developing common understanding on prudential management and supervision among industry and regulators. So, in 1998, officials of national supervisory authorities met in seminars held by the EFRP, which, according to its own interpretation, took on an "educational role" in the technical support of the Commission. At these meetings, the EFRP presented newest management and risk-control strategies, which caused „vivid interest yet

also some scepticism and doubts about the soundness of the exposed theory“ (EFRP 1998: 11). Meanwhile the pension consultancy firm Pragma Consulting developed a study for the Commission on the topic „Rebuilding Pensions: Security, Efficiency, financial viability“. It relied on information provided by 180 financial firms in Europe and outlined benchmarks for a “European framework for good professional practice in occupational retirement provision” (Europäische Kommission 1999). At a conference, John Mogg welcomed the report, which would have been launched at a “very opportune moment”, because the Commission planned a new draft directive. Therefore, it would be „extremely valuable […] to have a synthesis of current thinking in the market on what efficient EU pension fund supervision should be.” The study could provide guidance in a field of extreme technical complexity and national diversity of pension markets and help the Commission in determining the directive`s new content. (Mogg 1999).

However, one of the main driving forces for the Commission`s active stance on this issue derives less from regulating this segment *per se*. Rather, EU financial market integration and thereby also the development of risk capital markets gained momentum since the mid-1990s (see Bieling and Steinhilber 2002). This process culminated in the 1999 Financial Service Action Plan, itself becoming part of the Lisbon Agenda and therefore the often cited objective to turn Europe into the most “competitive region in the world”. The Action Plan defined the directive as one of its high priorities and underlines that the original driving force for regulating pension funds at an EU-level – financial market integration for competition with other financial centres, notably the U.S. – still prevails. So the communication „Risk Capital: A Key to Job Creation in the European Union“[10] underlines the negative development of European financial markets in comparison to the U.S. and highlights the regulatory, economic, fiscal and cultural barriers to an “entrepreneurial culture” in the Union. One of the main hindrances would thereby root in the restrictive regulation of insurance companies and pension funds, preventing those from investing in riskier assets. Related changes in supervisory rules, therefore, became part of the “risk capital action plan” (p. 11f., 23). The underlying argument builds primarily on the stated effects of the „prudent investment principle“ for capital market development in the U.S.:

> “A further striking difference concerns the extent to which US pension funds contribute to the provision of venture capital in the US. Spurred on by what is termed “prudent man regulation” adopted at the end of the 1970s, the United States pension funds have provided a growing source of capital […]. Furthermore, this prudent man legislation, through the diversification process, has allowed a

[10] SEC(1998)552 final

> significantly higher real total annual return […]. This is because experience shows that in the long run, the return on equity investment out-performs the yields on government bonds or property. […]. Here there is a treble dividend. First: removing unnecessary restrictions on pension fund investments or other institutional investors releases extra capital for risk capital investment in the economy. Second: improving the pension fund benefits for pensioners. Third: lowering the cost of funding of pension contributions, translating into increased competitiveness" (p. 6f.).

But the strong efforts by the European commission, and particularly its internal market directorate, to build a consensus around the content of European regulations by changing its discoursive and regulatory approach may not disguise that also societal actors developed particular interests regarding EU pension fund regulations. This primarily accounts for the financial industry, which partly aimed at arriving at a common view on regulations and thereby bridging the gap between the investment, respectively pension asset management industry and European insurers. The basis for this development appears twofold. On the one hand, many insurance companies themselves began to regard the pension asset management business as a new profit opportunity and developed own asset management subsidiaries. On the other hand, the possible concentration of pension funds from different jurisdictions under a single market regime promised scale effects, which could lower administration costs and increase market leverage. According to estimations by the Financial Service Roundtable, the creation of European pension funds of equal financial weight as their U.S. counterparts could lead to a cost-cutting for the Europe`s financial industry of 10 Billion Euros p.a. (Financial Times, 11.03.2003). Not at least, efforts to arrive at a common perspective increased also between the once strongly opposed political arms of both financial sectors involved in pension fund management. Alan Pickering, former trade union representative, NAPF[11] and EFRP president and meanwhile senior of pension consultant Watson Wyatt describes his strategy as EFRP president concerning the directive as following:

> "[O]ne of the things that I´ve been trying to do at the EFRP, is to build much better relationships with the CEA than the EFRP has when it`s been Dutch- or Irish-dominated. One of the things that I tried to do when I was NAPF Chairman was to work more closely with the ABI[12], and I was very lucky that Laurie Edmans was the ABI pension spokesman while I was at the NAPF, so we´ve got a much better working relationship here in the UK, I´m trying to do a similar thing in Europe and as happenstance would have it John Bowman from CGNU[13] is my equivalent in the CEA and we had hoped that we

[11] National Association of Pension Funds
[12] Association of British Insurers
[13] British Insurance group (now Aviva plc)

> could be able to have a common stance on the compromise for the directive" (Pickering, cit. in Connell 2006: App.)

But also transnational corporations and their pension consulting firms opted for European standards for pension management and investment, although their interest somewhat dropped when it became clear that tax issues would not be covered, what makes the establishment of administrative cost-reducing, pan-European pension schemes possible. However, cost reductions through higher returns on investment became an issue of strong support (Bolkestein 2002; Financial Times 01.04.2002). In contrast, labour representatives at the EU-level remained generally sceptical concerning the development of supplementary pension and stressed the priority of state pension schemes. Nevertheless, it would be

> "[…] vital to establish a minimum number of rules because it is essential to protect the rights of contributors and pensioners and to promote employment, without however impeding managers' room for manoeuvre or the freedom of movement of capital. These rules would relate inter alia to the need to ensure "prudent" management, and would therefore prohibit purely speculative investments and cover the amount of provision necessary to guarantee the rights of pensioners and future pensioners according to the technique chosen" (European Trade Union Federation 2000).

3.3 "Conflict over prudent investment" continued

Against this background, first internal commission drafts of the directive attracted straightforward criticism, particularly from British finance managerial circles, because those did not include an explicit prohibition of quantitative investment rules (Financial Times, 28.02.2000). Moreover, they excluded particular occupational pension arrangements of the biggest pension markets France and Germany. Here, occupational schemes have been partly financed either on a PAYGO (France) basis or through "book reserves" on the corporate balance sheet (Germany). British investment consultants therefore asked "what's the use of a directive if Germany and France are not properly covered" (ibid.). In the light of the additionally dropped harmonisation of tax regulations for occupational pensions, Alan Pickering thus concluded that barriers to a truly liberal pension system in Europe would persist, especially due to the "French insurance lobby" (ibid.).

However, the draft directive shifted back and contained the rule which required fund investment of a “prudent manner”.[14] So apart from protective measures for pension scheme members, fund management, transparency and oversight rules as well as free choice of service providers, it stated that investment decision-making may solely follow the principle of safety, quality, liquidity and profitability, whereby asset diversification should avoid the concentration of risk.

But only Ireland, the U.K., Sweden and the Netherlands supported the proposal, whereas countries such as France, Germany or Spain with quantitative standards requiring high shares of government bonds in the portfolio opposed this straightforward “Anglo-Saxon” approach (Financial Times, 07.04.2002). As a result, negotiations stopped for 18 months and have been re-opened by the Spanish delegation with a compromise, mixing qualitative and quantitative rules. Accordingly, investment in derivatives, hedge funds, “private equity” and the mother company sponsoring the pension fund should be limited. This so called “prudent-person plus” approach, however, met again fierce resistance from the financial industry circles in general and private equity as well as risk capital firms in particular. Whereas the president of the European Venture Capital Association saw the development of a European “enterprise economy” at stake, his British colleague claimed that pension fund experts should administer workers` money for retirement: „I have much greater faith in pension fund trustees than a committee sitting in Brussels" (Mackie, cit. in Financial Times, 01.04.2002; 07.04.2002).

Also the EFRP strongly opposed the proposal. Accordingly, “prudent person plus” may imply at its best, that countries with less experience in qualitative fund management and supervision receive further aid in fulfilling this principle (Financial Times, 01.04.2002).

Apart from these issues relating the investment of funds, the Council also hotly debated solvency rules. For protecting the scheme from default, the value of the scheme assets should always equal or exceed the liabilities when pension schemes guarantee pension benefits. Especially British pension fund managers and corporations rejected such claims. Many U.K. schemes show a high exposure to equity investment, eventually leading to temporary shortfalls in the scheme. Whereas corporate managers aimed at avoiding higher contributions through this stance, investment managers pointed at the implication of potentially lower demand for equity, when those solvency rules apply. Hence, U.K. officials referred to transparency regulation as sufficient means for pension security (Financial Times, 07.04.2002).

[14] In order to avoid conflicts over the term „prudent-person-approach“ and its association with Anglo-Saxon practice, the proposal relied on this terminology (Haverland 2004: 13).

The directive was finally adopted through a compromise, stating that the institutions for occupational retirement provision have to be managed according to the prudent person principle, whereby single countries may apply quantitative restrictions. Shortfalls of scheme assets should be avoided and mechanisms be put in place to correct them in settled time frames. Whereas for many commentaries the directive therefore failed to truly liberalise the occupational pension sector, others seemed more optimistic. For Frits Bolkestein, the directive with its achieved compromises meant the establishment of a European "light touch" regime in pension fund regulation, which would change the European pension fund industry considerably: „Pension funds will have a European passport which mobilises trillions of euros in capital for the financing of companies" (Bolkestein, zit. in Financial Times, 05.06.2002).
Peter Skinner, British member of the socialist fraction in the European Parliament, agreed. Yet, he also gave a different twist to this argument while looking at the channels through which this financing may take place:

> „This is good news for the big British pension providers who want to sell their schemes abroad. And for the people who work in financial service centres like London, Leeds, Manchester, Cardiff and Edinburgh this is a major boost for jobs and business. Britain has one of the most dynamic financial services industries in the world. Breaking down the barriers to give our financial services industry better access to over 300 million consumers in a single European market, will provide a massive boost for British industry" (Skinner, cit. in Beckmann 2007: 190).

3.4 Pension fund regulation and the limits to vagueness – the follow-up of the directive

With the adoption of the directive, however, the process of EU regulation in this field did not end. It rather changes its form, because now the implementation of the directive in the "spirit" of its underlying principles and objectives moved into the foreground. So Bolkestein`s successor McCreevy announced at a conference of the Irish pension fund association that

> "[o]ne of my main tasks over the coming years will be to ensure that the European regulatory framework for financial services supports the emergence of secure market-driven responses to retirement financing. […] We must remove regulatory or tax bottlenecks so that assets earmarked for retirement can be managed as efficiently as possible: to allow Europeans to enjoy the highest possible payouts and annuities on retirement. […] However, the Commission should only act where Member States cannot succeed on their own in providing sustainable and affordable pensions. I will, therefore, only start new initiatives where they provide a clear improvement of the current situation and only if EU action is necessary" (McCreevy 2005).

In the context of the Lamfalussy process, leading to the change of the EU regulatory committee structure for financial services, the Commission decided to widen the scope of the EU insurance committee to the realm of occupational pension provision.[15] This step would primarily follow from the adoption of the „pension fund directive“. So the avoidance of interpretation problems before its transposition in national law represents on of its main tasks (p. 12). The thus newly established „European Insurance and Occupational Pension Committee“ (EIOPC) links officials of relevant ministries for pension and insurance supervision and serves consultation and coordination purposes for the Commission. Moreover, the Commission transformed the former conference of insurance regulators into the „Committee of European Insurance and Occupational Pension Supervisors“ (CEIOPS). CEIOPS`s task is defined as supporting the Commission in “technical” affairs as well as directly formulating rules and standards for “best practice” in pension fund and insurance supervision. Moreover, stakeholder groups are integrated through consultative panels, whereby the “occupational pension committee” mere task is to build a „common understanding of the […] directive“ (CEIOPS 2004). After German pressure in the ECOFIN council to influence its location, the committee started its work in Frankfort in 2004 (Corinti 2005, Financial Times, 08.04.2004).[16] However, already at its first annual meeting in 2005, difficulties in fulfilling these objectives occurred. For Elmár Terták, director in the GD internal market, the main problem derived from the slow progress in the implementation:

> “[A] number of notifications are still outstanding and that the Commission's infringement proceedings will have to continue against the relevant Member States. I don't think I need to point out to anyone here what this kind of asymmetric implementation means for the well functioning of the Internal Market” (Terták 2005).

But also with regard to its genuine task of elaborating on a common understanding and application of the directive, conflicts occurred. For the EFRP representative, the work of the committee would be guided too much by the restrictive rules of life insurance directives:

> „Have decades of developing expertise in this field [of insurance supervision] led to a cast of mind that tends to seek an 'insurance-style approach' to new issues? […] I think succumbing to this temptation would be wrong. The EFRP asks you to consciously embrace a *new approach* - not just on cross-border cooperation but more generally (Lindblad 2005: Herv.i.O.).

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[15] See COM(2003) 659 final
[16] See the Commission`s decisions 2004/9/EC (EIOPS) and 2004/6/EC (CEIOPS).

However, somewhat contrary to this claim, many financial managers and regulators saw the problem rather in the vagueness of the directive concerning its application in practice. One of the main problems articulated in CEIOPS appears as the character of the directive as a financial service directive, which nevertheless ultimately touches upon national social security and labour law, without directly affecting the latter. But according to the EFRP representative in CEIOPS, the committee would have to accept that it represents the forum in which the „critical dialectic process between social policy elements and financial service rules must occur"(ibid.). Therefore the development of a coherent normative framework for the directive`s transposition may not be delegated back to the EU legislation process (ibid.: 4f.). Jochen Sanio, president of the German financial service regulator, even goes beyond the interpretation of CEIOPS as a mere regulatory platform adapting the supervision of the pension fund sector in the EU "for the benefit of pension fund members" (Sanio 2005):

> "CEIOPS must also think further ahead than that. It must develop a strategy with which the interests of Europe can be defined and asserted in this new age of globalisation. It will not be long before European insurance companies and pension funds are having to compete much more strongly with providers from all parts of the world" (Sanio 2005).

4. Conclusion

The paper explored into the question, why and how the "prudent person standard" developed as the framework for pension fund regulation at the EU-level and provided a historical narrative of this process. Despite the necessarily broad-stroke account given here, it may arguably lead to some interesting conclusions. Tracing the roots of regulations at the EU-level on pension fund management and investment shows that it its content of managerial discretion over the investment process fitted well with efforts of parts of the Commission as well as transnational capital groups to "unlock" pension capital and stimulate thereby capital market development against the background of U.S. competition and sluggish growth in the EU. However, the first attempt of launching a directive already showed the related trenches within Europe in the control of pension schemes and funds. Whereas the pension management industry under dominance of British, Irish and Dutch firms and broadly in alliance with state officials from these countries, generally supported liberalisation measures, insurers and states with larger control over pension fund investment, notably from continental Europe, generally

opposed it. Hence, the view that differences between an Anglo-Saxon approach to pension provision and a continental European model shape the politics of pension fund regulation finds strong support here.

However, the further development of the pension directive after its first defeat also entails another storyline. Apart from the discursive linkage to the pension reform debate and thereby its framing as a solution to broader societal debates, the manifold attempts to create a common outlook on the content of "prudent investment" and the control of pension funds appear striking. Those are not only put forward by the Commission, but also by industry circles and now in CEOIPS as a "technical" sub-committee and aim at aligning what can be called the "pension fund block" and an "insurance block" in pension fund regulation, whose implications for finance, but crucially also for social security and political agency are not yet fully understood.

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