Developments in Dutch pooling

**Briefing Asset pooling**

Recent bilateral agreements and regulatory developments are making the Netherlands more attractive as a jurisdiction for asset pooling, according to Wilfried Mulder and Mischa Muntinga.

Asset pooling, the joint investing by more than one investor, such as pension funds, insurance companies, other institutional investors, has charted an impressive course during the last decade. Recent tax developments have now made the Netherlands an even more attractive location for asset pooling.

Here, we give a brief description of the main features of asset pooling and the legal and tax aspects of the Dutch asset pooling vehicle Besloten Fonds voor Gemene Rekening (FGR). We also discuss the aforementioned tax developments, some international trends that may influence the pooling of assets and the consequences thereof for the position of the Netherlands as an international pooling location.

**Asset pooling benefits**

Through pooling of assets from different investors, a larger portfolio of assets is created. This provides several benefits for investors:

Firstly, a larger pool creates opportunities to build a more diversified portfolio. Investors may even get access to asset classes that would not be available to them in the case of an individual mandate as their size would be insufficient. Secondly, a larger asset base leads to economies of scale. Management fees and costs of service providers such as custodians and administrators will be lower due to the larger asset base. Furthermore, trading costs will be reduced because larger trades will bear relatively lower overall trading costs.

On the other hand, the consequences for the legal ownership of the assets and the impact of withholding taxes on investment performance should be examined carefully. This is where the Dutch FGR is distinctive from other pooling vehicles, such as the Luxembourg Fonds Commun de Placement (PCF) and Irish Common Contractual Funds (CCF).

In 2006, the Dutch Ministry of Finance began to promote the FGR in response to the introduction of the earlier mentioned Luxembourg and Irish vehicles. The ministry then highlighted the attractiveness of the Netherlands as an international asset pooling location and the suitability of the FGR as a vehicle for such pooling.

**Legal aspects**

In the Netherlands, it has been market practice for Dutch and foreign pension funds and other institutional investors to use the FGR as an investment vehicle. The FGR is not a legal entity, but a contractual arrangement under Dutch law between the investment manager, depositary and participants. Each participant in the FGR is entitled to a pro-rata share – based on the size of his interest in the FGR – of the assets and income generated by the FGR’s assets.

These entitlements are represented by participations, which are recorded in registered form; certificates are not issued. The FGR terms and conditions are flexible and can be tailored for each specific case. For regulatory purposes, the FGR is either subject to regulation (UCITS or AIFM, as from 1 July 2013), or exempt from this depending on the purpose of the vehicle.

**Tax aspects**

Under Dutch tax law, the FGR is treated as a fiscally transparent entity. This means that the FGR is not recognised for Dutch tax purposes and, as a result, not subject to corporate income tax and dividend withholding tax. Instead the participants in the FGR, wherever resident, each take into account for tax purposes their respective shares of assets, liabilities and income items (eg, dividends or interest) paid to the FGR. As a result, participants are subject to tax on their proportionate share of the FGR’s income in the same way as if they would have realised the income of these assets directly. So for tax purposes the participants can be considered the beneficial owners of the FGR.

This concept of tax transparency is important in an international context, but complex.

Asset pooling is beneficial to investors as long as investing through a pooled vehicle does not lead to a higher tax burden than investing directly. This means that a pooled vehicle should not be qualified as a taxable entity. Depending on the investment mandate, the pooling vehicle could in case of taxation result in a negative impact on investment performance of 50 basis points on an annual basis compared to direct investment.

Being tax transparent, the participants – although not the FGR itself – are entitled to claim tax treaty benefits on dividend or interest income, being the lower of the domestic rate of the source country of investment or the treaty rate. To enjoy these rights, both the country of investment and the country of domicile of the FGR investor should regard the vehicle as tax transparent. In other words, not only the Netherlands but also the investment countries and the investor countries need to qualify the FGR as tax transparent.

**Recent developments**

From 2006, the Dutch Ministry of Finance has worked with its tax treaty partners to achieve bilateral agreement to treat the FGR as tax transparent similar to its status under Dutch tax law. Once such agreement is reached, investors through a FGR are, for withholding tax purposes, treated in the same way as if they would have invested directly in the assets of the FGR. During the last few years, the Netherlands has reached a significant number of such bilateral agreements with other countries on the tax quali-
cation of the FGR, such as with Canada (2010), the United Kingdom (2010), Denmark (2011), Norway (2012) and Germany (2012). A ground-breaking development has been the closure of an agreement between the Netherlands and the United States on the tax transparency of the FGR in 2012. Very recently, in December 2012, an agreement was closed with Spain.

These agreements have made the Netherlands an attractive location for centralising international asset pooling activities, because they provide for the important advantage of clearance in many countries on the treatment of the FGR as tax transparent.

As a result, investors are entitled to claim treaty benefits in these countries as if they would have invested directly.

**International market developments**

Within a number of months, the European Alternative Investment Management-Directive (AIFMD) must be implemented by member states. As a consequence, investment funds will be regulated either as a UCITS or an AIFM fund. This regulatory development triggers asset managers to review the preferred location of choice for their activities and fund vehicles. The ongoing support from the Dutch authorities for the FGR as a tax transparent pooling vehicle is relevant in respect to this review. As stated, the choice of location and form of the investment vehicle may impact the performance of its investors considerably. The Dutch FGR has proved its effectiveness and is increasingly beneficial to other vehicles with respect to tax efficiency.

**Conclusion**

Recent agreements with other countries on the tax transparency of the FGR have made the Netherlands an attractive jurisdiction for asset pooling. This is relevant because recent regulatory developments (such as AIFMD) will trigger asset managers to review the preferred location for their activities and fund vehicles. In this respect, it should be noted that the attractiveness of the Netherlands could even further increase in the near future, taking into consideration its aim to conclude similar agreements also with further countries.

Attention should be paid to the fact that the Netherlands can not only be considered as an attractive asset pooling location, but also as a good location for pension pooling. The Netherlands has, based upon the EU IORP Directive, created an international pension pooling entity in its national legislation in the form of the Premiepensioeninstelling (PPI). The PPI can be used for operating defined contribution (DC) schemes.

In addition, as of February 2013, the Dutch ministries of social affairs end finance, initiated a consultation process on a future Algemene Pensioeninstelling (API), a new cross-border pensions vehicle that should be able to operate all types of pension schemes – DC, DB and hybrid. The availability of both the PPI and the API will, besides its attractiveness as an asset pooling location, contribute to the increased attractiveness of the Netherlands as a location for international pension pooling.

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A tale of two jurisdictions

Expatriate pensions are still an offshore game, and Luxembourg and Liechtenstein are vying for supremacy, writes Gail Moss

**Board Briefing** Expatriate Pensions

Despite – or perhaps, because of – the global financial crisis, multinational companies are paying more than ever to recruit the best people for senior positions. The benefits package is a key weapon in the battle.

“Historically, companies were offering attractive expatriate expense allowances to attract talent and encourage key management to move to different locations,” says Jana Mercereau, senior international benefit consultant, Towers Watson. “Now, given the global financial crisis, it is pension plans which are a must-have to play.”

However, while a major consideration will be the size of employer contributions, an equally important issue will be to ensure that employees who move from country to country are not disadvantaged, compared with their position had they stayed at home.

But as cross-border pension plans...
within the EU still struggle to establish themselves, with only around 80 in existence, two offshore players – Luxembourg and Liechtenstein – are slug it out with their bigger competitors to provide a base for multinational pension plans.

“What’s driving the offshore market is the need to make plans comparable with what is offered employees in established pension markets,” says Mercereau. And while pension plan design for a specific country is driven by pensions and tax legislation in that country, offshore plans enjoy more flexibility.

“In particular, top providers are offering open architecture products where plan members can choose from a universe of funds and benefit from institutional rates, as well as flexibility around contributions,” she continues.

Both Luxembourg and Liechtenstein have their benefits and drawbacks.

### The EU option

Luxembourg, as a well-established financial centre, benefits from good providers, experienced personnel and a benign legal and tax environment.

As an EU member state, it can offer employers not only an Institution for Occupational Provision (IORP), but also trust- and contract-based schemes.

The latter types of scheme offer the ability to outsource the administration function, including adding new members and paying out benefits. Few providers at present, however, can administer an IORP.

Crucially, contract-based schemes can be set up on an individual basis, so a member’s plan can move with them if they change company.

It was largely for security and investment reasons that Aegon based its insurance-backed International Pension Plan – aimed mainly at global companies wherever they are based, with employees located all over the globe – in the Grand Duchy.

“Luxembourg is a European financial centre, so it has strong financial regulation and consumer protection,” says Mark Green, DC product manager, Aegon Global Pensions. “As a small country with a focus on finance, it’s very important to Luxembourg to retain its position. So there’s a great incentive to maintain strong controls which offer investors, such as the sponsoring employers of expatriate pension plans, peace of mind about the money they choose to locate there.”

The Luxembourg life and pensions industry is tightly regulated by the Commissariat aux Assurances (Insurance Commission), which requires a quarterly external audit on all insurance companies.

The tripartite agreement between Commissariat, insurance company and custodian, with additional supervision and intervention mechanisms, gives the Commissariat powers to intervene to protect the interests of policyholders should it decide this is necessary.

“The potential for insurance company solvencies is always a concern to companies wishing to establish a retirement plan,” says Mark Price, principal in the international consulting group at Mercer. “The tripartite arrangement and other supervision mechanisms from the CAA helps with risk mitigation.”

Data protection laws are also administered more rigorously than elsewhere in the EU. But this can be a double-edged sword. “While our clients appreciate the strong controls we put in place to comply with these confidentiality requirements, they also need us to provide management information to help the governance of their pension plans,” says Green. “The procedures we have developed in collaboration with the regulators can make it easier for those employers to access management information, but the rules can also make some things more difficult. For example, when corresponding with the employer we have to use unique identifying numbers rather than members’ names.”

“Though there are strict rules around data protection, Luxembourg is governed by a light-touch approach,” says Mercereau. “There is no requirement to make tax filings, whereas typical onshore plans need regulatory approval to obtain tax benefits.”

Luxembourg’s insurance framework is built around the French model, so Aegon’s investment range is structured to give access to French capital guaranteed funds as well as external fund links. The funds offer capital guarantees with an annual ratchet, so interest, once it is added each year, cannot be taken away.

The plan is tax-neutral, so employers’ contributions are tax-deductible. There is no withholding tax on investment income, and no Luxembourg tax on payouts.

### At a glance

- Pension plans for expatriate employees offering benefits ranking with their home plan are a vital means of recruiting talent for multinational companies.
- Both Luxembourg and Liechtenstein offer both an IORP pension vehicle, and offshore plans.
- Luxembourg has strong financial regulation and strict data protection.
- Liechtenstein has a strong system of financial market supervision, compatible with EU rules.

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“There are no reasons why Liechtenstein should be excluded as a domicile. Many decisions about jurisdictions for offshore pension plans are made according to the availability of vehicles and providers, rather than location”

Mark Price