Briefing

Initial Appraisal of a European Commission Impact Assessment

European Parliament

October 2017

Pan-European Personal Pension Product (PEPP)

Impact Assessment (SWD(2017) 243, SWD(2017) 244 (summary)) of a Commission proposal for a regulation of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP) (COM(2017) 343) and a Commission Recommendation on the tax treatment of personal pension products, including the pan-European Personal Pension Product (C(2017) 4393 final)

Background

This note seeks to provide an initial analysis of the strengths and weaknesses of the European Commission's impact assessment (IA) accompanying the above proposal, adopted on 29 June 2017 and referred to Parliament's Committee on Economic and Monetary Affairs (ECON).

Pension systems across the EU vary considerably. While state-based public pensions constitute the most important part of retirement income, they may be complemented by occupational pensions and/or (national) personal pensions (private pension savings by households) (IA, pp. 4-5).[1] The IA observes that although demographic change and limited public budgets increase the pressure on public pension systems and their adequacy, currently only 27 % of the EU population between 25 and 59 years old, representing 13 % of the total EU population, invest in personal pensions (IA, p. 11, Annex 6, pp. 97-98). Moreover, the 2015 Action Plan on a Capital Markets Union found the single market for personal pension products to be highly fragmented, due to divergent national and European rules. It concluded that this fragmentation prevented providers from developing innovative and competitive products and savers from receiving good quality, flexible and easily portable personal pensions (IA, p. 4, 9). The availability of personal pension products varies widely from Member State to Member State, and the existing offers differ considerably as regards both their accumulation (saving) and decumulation (pay-out) phases; this makes their portability difficult and leads to a generally low take-up.

Against this backdrop, as announced in its mid-term review of the Capital Markets Union Action Plan, the Commission came forward in June 2017 with a legislative proposal to create a voluntary pan-European personal pension product (PEPP). The aim is to complement the existing national personal pensions and to encourage private capital investments in retirement savings on an EU scale. Given the relevance of tax incentives for personal pension products, the proposal is accompanied by a recommendation on tax treatment of such products by Member States, which is also covered by the IA under examination.

Problem definition

Driven by diverging national legal requirements for personal pensions, including taxation, and by an insufficient supply of personal pension products in some Member States, the IA identifies **three problem areas**, illustrated in a comprehensive problem tree (IA, p. 26):

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[1] For more background information see D. Eatock, European Union pension systems, adequate and sustainable? EPRS, European Parliament, November 2015 and D. Eatock, Framework for a Pan-European Personal Pension (PEPP), EU Legislation in Progress, EPRS, European Parliament, September 2017.

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1) Underdeveloped capital markets in the Capital Markets Union (IA, pp. 9-13):
According to the IA, the level of total investment assets by pension funds in the EU is around 30 %, compared to other advanced economies that attain 79 % or even 118 % (USA, Switzerland) (IA, p. 9). The IA points out that, in general, European households prefer deposits (IA, pp. 9-10). In addition, it notes that voluntary long-term pension products are concentrated mostly in five Member States: The Netherlands, United Kingdom, Czech Republic, Belgium and Spain.[2] The IA considers pension fund assets important for stock market capitalisation as they tend to promote depth and liquidity in the capital markets (IA, p. 9, 11). It concludes that the low level of personal pension savings of EU households hampers the development of the Capital Markets Union, thereby reducing investment opportunities for the economy, jobs and growth, as well as better access to more competitive and cheaper funds for borrowers and investors (IA, pp. 9, 11-12).

2) Insufficient features in the area of personal pension products (IA, pp. 13-20):
According to the IA, the current system suffers from a lack of standardisation of personal pension products. The greatly diverging national rules mean that there is a lack of portability of savings, which explains their low attractiveness and take-up. Differences concern especially the information and advice available to consumers, the distribution of the pension product (for example by insurers, independent advisors or online), their levels of return, more or less flexibility to switch between products, varied options of decumulation (annual, lump sum or other pay out) and the protection of the long-term investment (type of guarantees on the capital). The IA highlights in particular that 80 % of personal pension products are sold by insurers, the rest by pension funds or asset managers, limiting the variety and quality for savers (IA, p. 19).

3) Incomplete internal market for personal pension products (IA, pp. 20-25):
Due to the divergent rules and legal requirements for personal pensions in the Member States, the recognition and the transfer of pension contributions across providers and across Member States is either contractually prohibited or difficult in practice. In particular, the tax deductibility of contributions varies widely across the EU (IA, pp. 22-23). Therefore, 'mobile' consumers, who expect to move between countries, choose other means of saving for retirement, instead of having to sign up for multiple pension products.

The distinction between the problems and their consequences is not entirely clear from the IA. While the text features the identified problems as listed above, in the ‘objectives’ section and in the corresponding problem tree it cites ‘insufficient cross-border portability of personal pensions’, leading to ‘low uptake of personal pension products’ as a third problem (IA, pp. 26-27). The divergent national provisions and lack of portability are described under both problems 2 and 3, and some confusion is noticeable when the single market and the growth aspects are mixed with all three problems. In the interest of a clear and consistent impact assessment – which is always based on the problem definition – a clearer distinction between each problem and its consequences, together with an indication of possible interdependencies between problems, would have been preferable. The IA mentions four other, wide-ranging factors contributing to the above problems, which are, however, out of the scope of the IA, namely: aging population, adequacy of retirement income, lack of purchasing power and self-employed workers without adequate pension coverage (IA, pp. 24-25). Finally, the IA considers all EU citizens, in particular the 11 million cross-border workers, as well as insurers, pension funds, asset managers and banks to be affected by the initiative. Member State public authorities would also be affected as they would ensure the supervision of the implementation of a new European personal pension product (IA, Annex 3, p. 81).

Objectives of the legislative proposal

According to the IA, the **general objectives** of the Commission proposal consist in increasing pension savings in the capital market to promote additional financing for long-term investments and the completion of the Capital Markets Union (IA, p. 27). Moreover, the creation of a standardised framework for a European personal pension

[2] Annex 6, p. 98, cites Germany, Belgium, the Netherlands and the UK as having a well-developed personal pension market.

product aims to bring quality standards, simplicity and transparency to the personal pension market. By also facilitating cross-border portability, it is expected to contribute to the creation of a single market for personal pensions, with increased competition, lower costs and potentially higher returns (long term). Directly deriving from the three main problems identified, the IA spells out **three specific objectives**:

1) increase investment in the EU and contribute to completing the Capital Markets Union;
2) enhance product features on the personal pension market;
3) enhance the cross-border provision and portability of personal pension products.

The description of the *general* objectives reflects the rather imprecise complexity of the confusing problem definition. They do not appear to be *general* as defined by the Better Regulation (BR) guidelines[3] (toolbox, p. 100), i.e. referring to Treaty objectives, but rather specific as they refer to several shortcomings in the personal pension market and the Capital Market Union. Still, the three objectives labelled as 'specific' in the IA seem pertinent and are in line with the Capital Markets Union Action Plan (see above), the principles of the single market, in particular the free movement of workers, and partly with the Commission's 2012 White Paper on Pensions[4] (IA, p. 27). It is not immediately apparent, however, if they fulfil all 'S.M.A.R.T.' criteria of the BR guidelines, which require objectives to be specific, measurable, achievable, relevant and time-bound. This appears all the more important as the IA does not present any *operational* objectives (required by the BR guidelines). Therefore, a more targeted definition of deliverables of the objectives would have been useful to ensure a transparent assessment – as well as effective monitoring and evaluation of the achievement of the objectives in the future.

Range of options considered

This IA is conducted as a **three-step exercise**, starting with a rather short assessment of three 'high level policy options' to determine the general policy approach. This is followed by an assessment of the options to implement the selected policy approach, before finally analysing the 'overall impacts' of the preferred option. According to the IA, the decision on the most suitable 'high level' option is mainly based on the replies received from the stakeholder consultation and on its political feasibility (IA, pp. 31-36). The **three 'high-level' options** retained for assessment are the following (the preferred options of the IA being shaded in grey):

Option 1: Baseline scenario: No policy action.
Option 2: Creation of a Pan-European Personal Pension Product (PEPP) based on a set of common, flexible features in a voluntary, parallel EU pension regime in addition to the existing national personal pension regimes.
Option 3: Harmonisation of key features of existing national personal pension regimes, including their disclosure requirements, taxation, type of providers and prudential supervision.

This range of options is rather narrow, as option 1 is considered ineffective and option 3 seems politically not feasible. The IA explains that the options of a 'code of conduct' and a 'personal pension account' were discarded because they would not sufficiently address the objectives (IA, p. 31). Furthermore, the former would lack legal certainty and the latter standardisation and cross-border benefits, while implying, as in the USA, a 'federal' tax on personal pension products, another aspect not covered by the IA. The assessment and comparison (IA, pp. 37-38) of the three retained options concludes that option 2 is the preferred one; a new PEPP is expected to mobilise financial assets of households towards capital markets, set higher standards for personal pension products and facilitate cross-border transfer and portability. Option 1 would not attain any of these objectives, while option 3 would be more effective on all accounts, but would also entail upheaval of national pension markets and considerable compliance costs for providers the great majority of whom therefore rejected it, as did several Member States (IA, p. 38, 57). According to the IA, the preferred option 2 was strongly supported by consumers and to some extent by providers in view of its potential benefits for capital markets.

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[3] See SWD (2017) 350 final (Better Regulation Guidelines), 7.7.2017), p. 20.
[4] Although the focus of the white paper was on adequacy and sustainability of pensions.

The **second step** of the IA provides an analysis of the impacts of different options to standardise the key elements of the new PEPP. After specifying **five key features,**[5] based on the five most sold national personal pension products,[6] the IA screens a set of policy options for each of them (IA, pp. 40-51):

1) Distribution rules of PEPPs

Option 1: Apply existing EU sectoral legislation (or if absent, national legislation).
Option 2: Create a stand-alone specific regime for PEPP, covering all aspects of distribution, advice and information requirements.
Option 3: Create limited specific PEPP rules and combine with the application of existing sectoral rules.

2) Investment rules (regarding risk mitigation) for PEPPs

a) for savers
Option 1: Apply existing EU sectoral legislation (or if absent, national legislation).
Option 2: Require specified risk-mitigation for default[7] option and risk-mitigation technique for the choice of the provider for other investment options.
Option 3: Require specified risk-mitigation and investment protection for all investment options.

b) for providers
Option 1: Apply existing EU sectoral legislation (or if absent, national legislation).
Option 2: Introduce a general principle of prudent investment for PEPP providers (restrictions for use of derivatives).
Option 3: Introduce investment targets and limits.

3) Rules on switching providers of PEPPs

Option 1: Apply existing EU sectoral legislation (or if absent, national legislation).
Option 2: Allow switching without any costs.
Option 3: Allow switching without regulating possible costs.
Option 4: Allow switching and cap the exit charge for providers.

4) Cross-border portability and provision of PEPPs

Option 1: Apply existing EU sectoral legislation (or if absent, national legislation).
Option 2: Allow cross-border transfer of assets by creation of new national compartment if the investor moves cross-border; allow transferability of assets between sections within a PEPP.

5) Decumulation options (pay-out) of PEPPs

Option 1: Apply existing EU sectoral legislation (or, if absent, national legislation).
Option 2: Allow only one specific decumulation option (for example, annuities).
Option 3: Allow providers to develop all possible types of decumulation.

[5] The key features do not concern social, tax or labour laws, which remain under national competence, as well as conditions of the accumulation or the decumulation phase (IA, p. 38).
[6] Based on their market penetration index (IA, pp. 52-53).
[7] The default investment option is the one a fund chooses for those members who do not choose an investment option, usually based on the age and risk profile of the average member of a fund.

In addition, the IA presents three options to address the **taxation treatment of the PEPP**:

Option 1: Baseline scenario (national tax treatment).
Option 2: Favourable tax treatment encouraged by Commission recommendation even if not all national criteria are fulfilled.
Option 3: Creation of an EU (PEPP specific) tax regime.

Scope of the Impact Assessment

Although it determines the general policy approach to tackle the problems and to achieve the objectives, the **first step** of the analysis (the three 'high-level' options) is fairly limited and primarily based on the stakeholder feedback (IA, pp. 35-38). It does not check systematically all impacts and does not mention social, environmental or other implications,[8] nor details about the costs of the options. The quantification of the potential benefits of the preferred option relates to the uptake of personal pension products, which is estimated to be €0.7 trillion today and €1.4 trillion under the baseline scenario in 2030. By modelling consumer choices, market potential and pension fund investment portfolio, the IA foresees a rise to €2.1 trillion under the preferred option, i.e. with a PEPP (IA, pp. 32-34, Annex 4, pp. 82-85).[9] This estimation is, however, based on the important assumption that the new PEPP would be granted the same favourable tax treatment as existing national personal pensions – if not, the IA acknowledges that the outcome would be close to the baseline scenario (IA, p. 35). Despite repeatedly underlining the importance of this assumption (IA, p. 7, 34-36, 38, 55-57, 61, 63), the IA does not analyse the issue further (for instance, the probability of this happening or Member States' intentions in this respect), nor does it explain why it seems to assume that Member States would indeed grant the tax incentives.[10] The 'high-level' options are checked regarding their effectiveness, coherence, efficiency and political feasibility, with the latter two being decisive for the selection of the preferred option 2 (IA, pp. 37-38).

The **second step** of the analysis, i.e. the assessment and comparison of the options for each of the five key features of the new PEPP and for its tax treatment, results in a summary of the selected most effective, efficient and coherent options (IA, pp. 58-59). The range of options and the qualitative analysis of each item are broader than at the first level, but the analysis remains also relatively synoptic. The **third step of the IA** provides an assessment of the 'overall impacts' of the combination of the preferred options, looking specifically – yet also only rather briefly – at potential macro-economic impacts, at SMEs, administrative burden, the EU budget, social and environmental impacts and third countries (IA, pp. 59-65). The macroeconomic implications are analysed for the supply and demand sides, based on the same estimations of increased uptake of personal pensions following the creation of the PEPP that had determined the first level assessment (€0.7 trillion more than under the baseline scenario). Overall, the IA expects the PEPP to make limited positive contributions to capital markets and to the creation of jobs and growth (IA, p. 62). It also quantifies the potential contributions to capital markets (€14 billion in unlisted infrastructures). This would equal 5 % of the funding expected to be generated by the European Fund for Strategic Investments (EFSI), or an estimated €28 billion in alternative investments, which would equal 5 % of the total market value of European private equity funds (IA, pp. 62-63). However, without a clear indication of sources and a comprehensive explanation, the way these estimations were made is not transparent. As for the other assessed areas cited above, the elements provided are coherent, but the analysis could have benefited from further substantiation and a more detailed discussion of the direct and indirect implications. The same applies to the positive social impacts of the preferred option suggested (but not quantified) by the IA based on increased retirement income from personal pension products for savers (IA, p. 65). While the IA notes a positive impact on fundamental rights, including data protection, the right to property and to conduct a business, and to consumer protection, it does not expect significant environmental or

[8] There could be regional impacts, for instance, considering that certain regions have more mobile workers than others. The BR guidelines require a review of all potentially important impacts, regardless of whether they can be assessed precisely, and an explicit statement if economic, social or environmental impacts are not considered significant.
[9] Cited sources are: Mercer, EIOPA, EEA and OECD, Annex 4, p. 86; estimations provided by the supporting study of the IA.
[10] In terms of harmonisation of national tax requirements for existing personal pension regimes (option 3), it mentions 'cautiousness' of professional stakeholders and opposition of Member States (IA, pp. 36, 57-58).

third country impacts (IA, p. 65). Despite the cross-border focus of the initiative, there is no mention of territorial impacts in regions where many mobile workers could be concerned.

Subsidiarity / proportionality

The IA concludes that EU action is necessary to overcome the fragmented national legal framework applicable to personal pension products, which currently creates costs for providers and workers (IA, pp. 29-30).[11] It underlines the complementarity of the preferred option as a voluntary alternative for retirement saving, without replacing or harmonising national provisions. Nevertheless, the IA notes that it could impose new reporting requirements on providers, particularly regarding cross-border distribution. In this context, it suggests including some general principles in the legislation to keep these burdens proportionate to the risks of PEPPs, especially in cross-border trade (IA, p. 65). It does not provide further details regarding these principles.
At the time of writing, no reasoned opinion from national parliaments had been received, the subsidiarity deadline expiring on 27 October 2017. The European Economic and Social Committee is preparing an opinion (adoption envisaged for October 2017).

Budgetary or public finance implications

The IA notes implications for the EU budget, namely for the European supervisory authorities, such as the European Insurance and Occupational Pensions Authority (EIOPA), who would take on the responsibility of ensuring fully consistent quality criteria for the authorisation, licensing, registering and passporting of the new PEPP (IA, p. 65). The additional costs are estimated at approximately €1 million in 2019 and €1.2 million by 2021.[12]

SME test / Competitiveness

The IA points out that many providers of personal pension products are SMEs (asset managers, investment firms) who are expected to benefit from the expansion of the range of providers and an increased demand (IA, pp. 64-65). Furthermore, it notes that additional private savings could be channelled towards capital markets – and from there possibly to SMEs. Their operating costs are expected to drop due to the standardised elements of the PEPP, which could improve their competitiveness, but the IA does not provide quantification or convincing analysis of this aspect (IA, pp. 35-36, 64). The indicated implications of the proposals for SMEs could have been analysed in more depth, including quantified information on costs and benefits. The IA also mentions as a benefit, but without further elaboration, the inclusion of the self-employed, excluded from state-based or occupational pensions (IA, p. 65).

Simplification and other regulatory implications

The standardisation of key features of the PEPP is considered generally likely to bring simplification and transparency to the pensions' market (IA, p. 12, 36, 43). At the same time, the IA explains that the PEPP is a new, additional and voluntary personal pension product the creation and oversight of which could cause additional administrative burden, depending on the supervision at national level. The IA would have benefited from a more thorough analysis of this aspect, be it qualitative or quantitative.

Quality of data, research and analysis

The IA cites an external study[13] and a workshop organised by the contractor, the technical advice from the EIOPA and a public consultation (see below) as its main sources (IA, pp. 7-9, Annex 2, pp. 69-80). It further refers

[11] The IA, p. 29 (footnote 79), cites a study showing that implies 25 % administration costs could be saved.
[12] The IA does not provide further explanations, but notes that under current co-financing arrangements of these authorities, 40 % will be included in the EU budget, not exceeding the current MFF (IA, P. 65). The legislative financial statement of the proposal, p. 68, contains calculations of the administrative costs.
[13] Study on Feasibility of a European Personal Pension framework, by Ernst & Young, June 2017.

regularly to OECD and Eurostat data and occasionally to other specified sources (IA, Annex 4, p. 66). However, the origin of some data is not transparent, as clear source indications are sometimes missing (IA, pp. 11, 61-62). The IA explains the analytical models used for the quantifications in Annex 4, underpinned by a list of literature (IA, Annex 4, p. 89). Most of the assessment is qualitative for all three steps, the first part, as indicated above, being mainly based on stakeholder feedback. Annexes 6 and 9 provide some information on the state of play of the personal pensions market in the EU. They also include a few national examples of current practices regarding some of the identified key features of personal pension products, namely on switching of pensions and current rules on advice for the consumer. The IA also contains a useful comprehensive glossary (Annex 5). Overall, the level and availability of information on the current situation appears to be satisfactory, whereas the research on future perspectives for personal pensions used for the IA process seems rather limited.

Stakeholder consultation

The IA clearly identifies the stakeholders affected by the problems to be solved as being all EU individuals saving for retirement, insurers, pension funds, asset managers and public authorities. All of them were targeted by the public consultation run by the Commission from 28 July until 31 October 2016 to prepare the IA (IA, p. 70). The consultation consisted of three separate sets of online questions matching each group of stakeholders. It received 585 responses, 494 of which from private individuals, 11 from consumer organisations and 80 from professional stakeholders (IA, p. 72). According to the IA, most stakeholders agreed on the need to complement public and occupational pensions with personal pensions and saw a lack of transparency of current personal pension products. Most professional stakeholders opposed a harmonisation of existing personal pensions, which seems to have been decisive for the first level assessment (of the principle policy approach) (IA, p. 31). Stakeholder views were also taken into account in the analysis of the 'overall impacts' of the preferred option, for instance the simple and safe default investment option (important for consumers) or the cross-border portability and tax issues (advocated by many professional stakeholders) (Annex 2, pp. 72-80). In addition, the IA points out that the EIOPA's technical advice was also partly based on two consecutive consultations undertaken in 2015 and 2016 (IA, p. 69).

Monitoring and evaluation

The IA identifies six key performance indicators – two per specific objective – to monitor the impact of the preferred option in view of a review after three years of its application (IA, p. 66-67). The indicators mostly refer to data collected by the EIOPA and ESA. They seem relevant for measuring the impact of the initiative, even if they appear quite limited in number and structure (mostly simply counting uptake and registrations of PEPPs). The IA also envisages the evaluation of the tax treatment accorded to the PEPP. In this respect, the Commission recommendation to Member States to grant the same tax relief to the PEPP as to their national personal pensions is mentioned in the proposal's explanatory memorandum and in some of its recitals. However, since the Commission recommendation is not legally binding, its impacts will depend entirely on the decision of each Member State.

Commission Regulatory Scrutiny Board

Major critical comments by the Commission's Regulatory Scrutiny Board (RSB) in its negative first opinion on a draft version of the IA report referred, inter alia, to the lack of evidence, explanation and quantification of the impacts of the PEPP, as well as to confusing objectives and policy options. The draft was rapidly revised by the lead Directorate-General FISMA (Financial Stability, Financial Services and Capital Markets), and received, through a written procedure, a positive second opinion with reservations, suggesting that the IA still contained considerable weaknesses.[14] While the RSB found some improvements in the revised draft, it still identified significant shortcomings, leading to a number of new recommendations for adjustments. The final IA does not explain if and how the comments of the RSB have been taken on board, nor does it contain an annex providing

[14] The draft IA was re-submitted roughly two weeks after the first negative opinion. Time pressure could also be the reason why the published IA, including annexes, carries the watermark 'Draft' from p. 28 onwards.

this information, as is required by the BR guidelines and toolbox.[15] It does not appear to respond fully to the comments, still containing inconsistencies (see under problem definition and objectives) and failing to thoroughly explain and substantiate, for instance, the impact on SMEs and the self-employed, the comparative advantage of the PEPP and open questions around the expected tax treatment.

Coherence between the Commission's legislative proposal and IA

The proposal for a regulation to create a PEPP largely follows the recommendations expressed in the IA, as does the complementary Commission recommendation on tax treatment. The monitoring and evaluation arrangements suggested by the IA, including the indicators, feature in the legislative financial statement of the proposal, but unlike the IA, the evaluation is envisaged after five years of application (not three). The proposal provides for the Commission to adopt delegated acts on some of the key features of the PEPP, namely the provisions regarding advice and information, as well as the oversight, governance and reporting requirements (explanatory memorandum, pp. 14-15). The Commission recommendation on tax treatment suggests setting up an expert group for the exchange of best practices in the Member States.

Conclusions

The IA provides useful input on the potential implications of the creation of a pan-European pension product. However, while the elements provided are generally logical, some parts of the analysis lack consistency and could have been more complete. For instance, a clearer definition of the problems could have provided a more solid ground for the analysis – even more so as the IA does not provide *operational* objectives and features a limited range of options. A number of provisions of the BR guidelines are not complied with, for example regarding the quality of the problem definition, operational objectives and response to the RSB opinions. In addition, some aspects that appear quite relevant, for example the adequacy of retirement income, are (explicitly) left out of the scope of this IA, which makes the reader wonder how big their impact would be. The three level structure of the assessment does not facilitate clarity about the impacts of the individual options. While the IA acknowledges that the benefits of the preferred option largely depend on favourable tax treatment by the Member States, it does not provide further insight into the probability of this happening. The expected costs and burdens of the initiative will occur regardless of the benefits and thus could have been analysed more thoroughly. While the IA describes the added value of the PEPP as a complement to national pension products, the assessment of the impacts does not entirely reflect this. In particular, the advantage of the preferred option compared to the baseline in the *absence* of tax incentives lacks substantiation, for instance as regards the benefits for SMEs and savers and the costs for providers and public authorities.

This note, prepared by the Ex-Ante Impact Assessment Unit for the European Parliament's Committee on Economic and Monetary Affairs (ECON), analyses whether the principal criteria laid down in the Commission's own Better Regulation Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal. It is drafted for informational and background purposes to assist the relevant parliamentary committee(s) and Members more widely in their work.

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Manuscript completed in October 2017. Brussels © European Union, 2017.

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[15] Tool 12, pp. 72-73, says the IA report *must* contain an annex explaining the consultation of the RSB.