SUMMARY

The ageing population in the European Union and the effects of the financial and economic crisis have strained the sustainability of public pension schemes in Member States (MS). To ensure adequate incomes for people after retirement, many MS are putting increasing emphasis on supplementary forms of retirement income. These include occupational pension schemes that provide retirement income based on employment earnings during working life.

Whilst MS are responsible for the design of their pension systems, occupational pensions affect, or are affected by, various EU policies and concerns. Free movement of workers means that workers should preserve rights in occupational pensions when they move to another MS. EU-wide companies need cost-efficient ways to provide pensions to workers in different MS. The European Commission has proposed, or will, improvements in both areas.

Workers also need cost-effective protection against risks (including employer insolvency) and reliable pension information to make good retirement decisions. Increasing reliance on occupational pensions may put women at risk of poverty in old age.

Though MS will continue to support a very wide variety of approaches to occupational pensions, the EU can contribute to ensuring that citizens enjoy an adequate and sustainable income in old age.

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Context

The 'ageing' of the EU population, as well as the financial and economic crisis, has affected public pension provision. Public pension expenditure in the EU is expected to increase from 2010 to 2060 by 1.4 percentage points, to 12.7% of GDP. However over the same period, the average replacement rate (public pension benefits as a percentage of earnings) is expected to decrease by 19%. As a result, supplementary pensions will increasingly be needed to complement public benefits and to ensure an adequate replacement of income after retirement for most workers.

Member States (MS) have implemented a wide variety of different pension systems and have different forms of supplementary pension. However occupational pensions, linked to an employment relationship, will make up the greater part of supplementary income for most workers.

Types of pension provision

In addition to personal savings or assets such as their home, retired people have three possible types of pension income,
referred to as 'pillars', following categories established by the World Bank1.

Public pensions (‘first pillar’)
Public pensions are statutory plans administered by the state and usually financed from social insurance contributions or general tax revenues. They provide benefits based on earnings, years of work or years of residence. They are usually financed on a 'pay as you go' (PAYG) basis, though some MS (in Central and Eastern Europe in particular) introduced mandatory funded individual plans as part of public pension provision. In most MS, public pensions provide the greater part of income in old age.

Personal pensions (‘third pillar’)
Personal pensions are private voluntary plans in which contributions are invested in an individual account managed by a pension fund or financial institution. They are usually defined contribution plans, where the level of assets determines the level of pension benefits provided. To encourage savings, MS often provide tax incentives or additional contributions.

Occupational pensions (‘second pillar’)
Occupational pensions are private supplementary plans linked to an employment relationship. Contributions are made by employers or employees, or both, based on earnings. These plans may be mandated by national legislation but more commonly are established either in employment contracts or in sector- or profession-based collective agreements negotiated by social partners. Pension liabilities may be assumed directly by the sponsoring company (as book reserves), or contributions may be invested in private funds or insurance contracts. Funding may be based on defined benefit or defined contribution principles (the latter are increasingly common). Particularly in MS where public pensions only provide a minimal level of support, occupational pensions allow many employees to even out consumption over a lifetime and to enjoy in retirement a standard of living close to that which they had during working life.

Glossary
Pay-as-you-go (PAYG): Revenue from current contributions is used directly to pay for current retirement benefits. Most public pension schemes are PAYG. (French: régime par répartition)

Funded (or pre-funded) schemes: Plans in which contributions are accumulated, invested over time and then used to pay pension benefits in the future. Most occupational pensions are funded. (French: plans de retraites capitalisés)

Defined benefit (DB): Level of pension payments are usually defined by a formula based on earnings, the length of employment and/or similar factors (e.g. minimum 35 years' service; earnings during 10 best years).

Defined contribution (DC): Level of pension payments are based on the total contributions to an individual account, adjusted for investment returns and costs.

Book reserves: The sponsoring employer enters sums on its balance sheet as reserves or provisions for paying future pension benefits. The employer may be required to take out insurance against bankruptcy.

Waiting period: The length of time a worker must be employed before being eligible to join an occupational scheme. Workers may also have to have attained a certain age.

Vesting period: The length of time a worker must be an active member of a scheme before being entitled to receive benefits.

Source: OECD, CEPS2

Occupational pensions are an efficient way of saving for supplementary pensions. They can offer wide coverage and economies of scale in governance, administration, asset acquisition and management. They provide greater risk pooling than individual plans, including inter-generational risk-sharing where younger and older people share risks in terms of investments, inflation and growth. Members can often benefit from not-for-profit plan management. Like personal pensions, occupational pensions may benefit from state fiscal support: 90% of the 140 occupational schemes catalogued by the European Insurance and
Occupational Pensions Authority (EIOPA) benefited from specific tax incentives.

Fig. 1 - Number of private pension plans/products in EEA by type (occupational or personal, DB or DC)

Nine MS do not have occupational pension plans. Until the early 1990s, occupational schemes were only well established in a few MS (notably Denmark, the UK, Ireland and the Netherlands); therefore only in these countries do they currently provide a significant portion of retirement income. Even so, in 2010, more than €4.4 trillion of assets were being managed for workplace pensions through more than 130,000 institutions in the EU. In addition, many MS are reforming their pension systems, moving towards multi-pillar pension systems to limit rises in public expenditure, to broaden risk-sharing and to increase stability in pension provision. As a result, the importance of occupational pensions in Europe is likely to increase in the future.

In the EU, MS are responsible for social protection including the design of pension systems: the EU’s role is to support and complement MS actions. However occupational pensions affect or are affected by many EU policies and concerns, including worker mobility and labour market flexibility, the single market for financial services, protection of workers and gender equality.

Data source: OECD, Pensions at a Glance, 2011. ‘Mandatory private’ and ‘voluntary DC’ categories include both personal and occupational plans.

Directive 98/49/EC provides very basic safeguards for the supplementary pension rights of employed and self-employed persons. It requires that workers who move to another MS be treated on an equal basis with workers who stay within the original MS in regard to their vested pension rights. In addition, it ensures that benefits are paid to a pensioner resident in another MS. However, it does not deal with the acquisition of pension rights (e.g. eligibility provisions such as waiting or vesting periods). Nor can a worker transfer rights to another occupational plan in another MS when moving to work there. These issues remain a potential barrier to the free movement of workers within the EU and the flexibility of the labour market.
be too burdensome, particularly for small pension plans, given both the wide variety of forms of occupational pensions in MS and complicated actuarial issues related to valuation of rights. The scope was also amended to explicitly include occupational schemes based on insurance contracts, PAYG schemes and book reserves.

Even so, Council could not reach unanimous agreement on the amended proposal, due largely to conflicting goals for occupational pensions. In some MS, long waiting and vesting periods are used to encourage employees to make a long-term commitment to an employer and hence ensure labour market stability.

The EC re-opened the debate with a Green Paper (2010) and White Paper (2012) on adequate and sustainable pensions. Since the entry into force of the Lisbon Treaty, the legal basis for the revised proposal (Art. 46 TFEU, on the free movement of workers) is now subject to the ordinary legislative procedure, so objections from a single MS can no longer block agreement.

In June 2013 the Council finally agreed on a ‘general approach’ to the 2007 amended proposal. The approach specifies that:

- Combined waiting/vesting periods are to be a maximum of three years, and age limits can be no greater than 21 years.
- Pension rights of an inactive member in another MS are to be treated in the same way as other members' rights (e.g. indexed for inflation) and schemes must provide appropriate information to cross-border members.
- Refunds are to be given to workers who leave employment before their rights are vested, or if the value of their vested rights is small.

While rules concerning workers who leave employment but who remain within a MS are no longer part of the Directive due to the new legal basis (i.e. cross-border mobility), MS would be encouraged to apply the same treatment to workers whether they stay in the MS or moved to another.

This new approach may finally lead to adoption of the amended Directive. However not all barriers to mobility will be removed. Taxation, an MS responsibility, remains a particularly difficult issue. Occupational pensions may be taxed on three different transactions: contributions, investment returns and pension payments. Most MS exempt contributions to occupational pensions and exempt investment gains, but tax pension benefits (the 'EET' system). However some MS have different approaches. Depending on which MS workers leave and which MS they go to, it is possible that their pensions could be taxed twice or that they escape taxation altogether.

Pan-European occupational pensions

The development of a single EU-wide market for occupational pensions could enhance the mobility of workers, as well as reducing costs through economies of scale and strengthening risk management. Directive 2003/41/EC on Institutions for Occupational Retirement Provision (the IORP Directive) aims to set minimum standards for pan-EU funded occupational retirement schemes (excluding PAYG plans, book reserve schemes and, optionally, small schemes with less than 100 members).

According to the Directive, IORPs based in one MS (the 'home country') can manage schemes for employers in other MS (the 'host' countries), and employers in one MS can set up schemes for their employees with an IORP in another MS. Prudential supervision of these financial institutions is the responsibility of the supervisory authority in the 'home' MS but plans must conform to the social and labour laws of the 'host'. On the one hand, considerable freedom is given to IORPs to determine investment strategies as long as they correspond to what a 'prudent person' would do. On the other hand, quantitative...
restrictions on investments can be imposed by MS, though they cannot prevent IORPs from investing up to 70% in equities and corporate bonds and up to 30% in foreign currencies. As a further protection, cross-border pension plans' liabilities are not allowed to exceed their assets at any time.

Despite expectations, the IORP Directive has not resulted in the creation of a dynamic EU-wide market. While multinational corporations have been able to sponsor a coherent schemes for employees located in various MS, the number of members in these plans is small. By June 2012 there were only 84 cases of cross-border activity in the European Economic Area; 58 of these were based in the UK or Ireland which already had cross-border schemes based on bilateral arrangements. It is estimated that outside these two countries, there were only a few thousand members of cross-border IORPs.

The chief barriers to the creation of pan-EU occupational pensions are considered to be:
- The burden of complying with the different social security and labour laws in each MS
- Different tax systems in MS
- Time-consuming set-up procedures
- Administratively complex reporting to members and supervisory authorities.

The EC is planning a revision of the IORP Directive to improve transparency and governance of occupational pension funds. The EC is also exploring the feasibility of establishing a pilot pan-EU multi-employer occupational pension for researchers, one category of highly mobile worker. Some analysts argue that such a special pension scheme would not be necessary if cross-border pension provision were properly supported. (The EP has also questioned the need for such a specific scheme.)

Some experts note that cross-border schemes could threaten the solidarity elements in some national DB plans, by allowing members to join a different scheme abroad; however only 3% of workers are employed outside their MS of origin. On the other hand, employers and pension funds might have an incentive to ‘forum shop’, seeking to establish plans in a 'home' MS in which regulations and enforcement were less strict.

### Other issues

#### Pensions and employer insolvency

Employers sponsor occupational pension plans and in most cases contribute on behalf of employees. The funds may be invested with a supervised financial institution, but in some MS (e.g. Germany) pension liabilities can be carried on the books of the company itself as book reserves. If the employer becomes insolvent, employees could lose their pension rights.

Directive 2008/94/EC on employee protection in the event of employer insolvency requires MS to adopt measures to protect the rights of members of occupational pensions. However this does not mean that pensions are fully guaranteed. The Court of Justice held in case C-278/05 that even a guarantee of just 50% of a worker’s pension rights is sufficient.

#### Risk management

The Solvency II Directive (Directive 2009/138/EC), which comes into effect in 2014, requires greater capital reserves as security on the part of insurance firms. Insurers offer contracts that provide pension benefits, and similar capital requirements for IORPs have been suggested to ensure a level playing field in pension provision. However various organisations, notably the European Social Partners and PensionsEurope, have stressed the different characteristics of IORPs, underlining that they have long-term liabilities, (often) not-for-profit management and a collective basis, and do not have the same need as insurance companies for short-term capital. In May 2013, the EC indicated it would not pursue this issue in the imminent revision of the IORP Directive.
Gender
Women suffer from a 'pay gap' in that their average earnings from work are below those of men. They also suffer from a 'pension gap'. In the EU-27 there is an estimated 39% difference in men's and women's income after the age of 65. While women live longer than men, this gap arises in part because women earn less, fewer women participate in paid work and they work fewer hours per week or fewer years in their career. Breaks women may take in a career (e.g. for childcare) can also have a disproportionate effect on pension rights if minimum ages for scheme membership are high and vesting or waiting periods are long.

Directive 2006/54/EC on equal opportunities in employment allows for different treatment for men and women in occupational pension contributions and benefits where these are justified by actuarial considerations. On a practical level, however, the increasing reliance on occupational pensions to supply adequate retirement income in multi-pillar systems may put more women at risk of poverty by tying benefits more closely to lifetime earnings.

European Parliament
In 2011, the EP passed a resolution on the EC’s Green Paper, calling for more in-depth analysis and coordination of MS pension systems, including tax issues, and the further development of occupational pensions in MS where this possibility does not currently exist. Two years later, in a resolution in response to the White Paper, the EP endorsed a multi-pillar approach to pensions, emphasising that occupational pensions should be based on collective employment agreements since these allow for greater solidarity. The EP also called for:

- Efficient tracking services to enable citizens to see all their entitlements in all MS and to make well-informed decisions
- Greater consistency in MS' protection of pension rights when an employer is insolvent
- MS agreements to avoid double taxation
- Recognition of care periods in calculating benefits and minimum levels of public pensions to ensure that women in particular are not at risk of poverty in retirement.

In 2011, the EP also called on MS to use more equality-enhancing actuarial calculations for men's and women's pensions, to better protect older women from risks of poverty.

Stakeholders
European representatives of employers, workers and industry jointly disagree with the proposal to apply Solvency II rules to pension funds: they feel strict capital requirements would favour short-term security over pension adequacy. BusinessEurope believes that actions to improve worker mobility need to be balanced with cost-effective provision of occupational pension schemes.

In a report on private pensions in three MS, the European Federation of Financial Services Users (EuroFinUse) called for better and more consistent disclosure of real rates of return from private pensions, (i.e. after administrative costs, taxes and inflation are taken into account). PensionsEurope, representing national associations of pension funds and providers, supports tax or social security rules that help with pensions and a uniform basis for taxation schemes across the EU (e.g. EET). They oppose a Financial Transaction Tax on pension investments, and support better information for plan members.
Main references


**When the welfare state meets the regulatory state: EU occupational pension policy** / M. Haverland, 2007.

**European pensions policy and the impact of the EU pensions directive for employers worldwide** / R. Ellison, 2012.

**Pension systems in the EU: contingent liabilities and assets in the public and private sector** / Policy Dept A, European Parliament, 2011.

**Scope of the coordination system in the pension field** / D. Ghailani et al., European Social Observatory, 2011.

Endnotes

1 Averting the old age crisis / World Bank, 1994 (Available from the World Bank site). While widely referred to, the World Bank’s classification is not the only one. The OECD favours a division into public pensions managed by the state, and private pensions (including most occupational and personal schemes) managed by private organisations. Others differentiate on the basis of initiator or governance and between mandatory pensions (required by law) and voluntary pensions (including occupational pensions voluntarily set up by employers but compulsory for employees).


3 For the EC’s 2012 Ageing Report, the Czech Republic, Estonia, Greece, Latvia, Lithuania, Hungary, Malta, Romania and Slovakia reported that occupational pension schemes did not exist or were irrelevant.


7 I. Guardiancich, D. Natali, *op. cit*.