

Prospects for occupational pensions in the European Union

SUMMARY

Given ageing demographics, Member States have taken action to reform their public pension systems to put them on a more sustainable footing for the future. The 2015 Ageing Report projects that, over the long term, there will be a reduction in public pension spending as a share of GDP in the majority of Member States, largely as a result of implemented pension reforms. The same report, however, notes that pension adequacy will also decline, on average. Against this backdrop, there have been calls in recent years for citizens to have greater opportunities to build up safe supplementary pensions. Some see occupational pensions, with their social partner involvement and possibilities they offer to share risks and reduce costs, as a good option.

The European Parliament has called on the Commission to encourage Member States to facilitate participation in occupational pensions and to make proposals for promoting such pensions where they do not yet exist. The social partners have also called for the promotion of occupational pensions. But currently only a few Member States have mature and significant occupational pension sectors and, as with public pension systems, they have been under pressure in recent years. Adjustments and reforms are helping to maintain these strong occupational sectors, but expansion, both within countries with existing provision and in particular in those that do not yet have significant occupational pension sectors, looks muted for now.



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Glossary

Adequacy: The adequacy of pensions is measured by their ability to prevent poverty, the degree to which they replace income before retirement and how they compare to the average incomes of people below pensionable age.

Funded (or pre-funded) schemes: Pensions in which contributions are invested over time and then used to pay pension benefits in the future. Most occupational pensions are funded.

Pay-as-you-go (PAYG): Revenue from current contributions used directly to pay for current retirement benefits, so they are not pre-funded, barring, in some cases, small reserve funds. Most public pension schemes are PAYG.

Sustainability: The sustainability of pensions relates to the fiscal and financial balance between revenues and liabilities (and the ratio of workers/contributors to pensioners/beneficiaries).

Taxonomy: There is no single agreed detailed taxonomy for pensions, but set out below is a typical three-pillar approach used in this briefing (more details on classifications can be found in a 2014 European Parliament [study](#) on Pension Schemes).

'First pillar' (public) pensions: Public statutory pensions administered by the state and usually financed from social insurance contributions and/or general tax revenues on a PAYG basis. In central and eastern European Member States in particular, **statutory mandatory funded individual plans, (pillar 1b pensions)**, have been introduced alongside pillar I.

'Second pillar' (occupational) pensions: Private supplementary plans linked to an employment relationship. Contributions are made by employers and/or employees, often with state support via tax advantages. These plans may be mandatory or quasi-mandatory and commonly established via employment contracts or by social partners in sector or profession based collective agreements. Normally pre-funded. They can be **defined benefit (DB** – pension linked to period of service and salary level) or **defined contribution (DC** – pension based on contributions paid and investment returns, less costs) or **Hybrid schemes (DB/DC** – combining some features of both, e.g. defined contribution, but with minimum guarantees.

'Third pillar' (personal) pensions: Personal pensions, that is pre-funded private voluntary supplementary plans in which contributions are invested in an individual account managed by a pension fund or financial institution. They may be tax-incentivised.

Context

Ageing demographics

The population in the European Union (EU) is ageing due to a combination of increasing longevity and low birth rates. [The 2015 Ageing Report](#) projects that life expectancy at birth for males in the EU will increase by 7.1 years, reaching 84.8 in 2060, and for females, by 6.0 years, reaching 89.1. In the same report, the [total fertility rate](#) is projected to rise from 1.59 in 2013 to 1.76 by 2060 for the EU as a whole, but this is still well below the natural replacement rate of 2.1. As a result the EU is projected to move from having around four working-age (15-64) people for every person aged over 65 years in 2013, to just two by 2060.

Resulting public (pillar I) pension reforms

Responding to these demographic changes and the pressure this puts on the affordability of pension systems (with fewer people of working age supporting more people drawing a pension), most Member States have made reforms in recent years. These changes have put public (pillar I) pension spending on a much more sustainable path. In fact, the 2015 Ageing Report projects that over the long term there will be a reduction in public pension spending as a share of GDP in the majority of Member

States,¹ largely as a result of implemented pension changes. These reform measures, which include changes to the retirement age and pension benefits, have primarily been adopted to address concerns about the fiscal sustainability of pension systems. The report notes that the gross average replacement rate² of EU public pensions (weighted average) is expected to decline from just under 48% in 2013 to a little over 35% in 2060. In simple terms this means that public pensions are, in general, expected to become less generous in future.

Limited EU competencies on pensions, but added scrutiny with European Semester

Pension systems are largely a matter for Member States, with EU level rules essentially limited to four main areas:

- Cross-border coordination of social security pensions,³ and minimum standards on the acquisition and preservation of supplementary pensions,⁴ to facilitate the free movement of workers and protect mobile workers' pension rights;
- Establishing an internal market for (most) funded occupational schemes and the necessary minimum standards on prudential rules to protect scheme members;
- Minimum guarantees concerning occupational pensions ('pillar II') and accrued rights in case of the insolvency of enterprises as sponsors; and
- Anti-discrimination rules which apply, in different ways, to the three pension pillars.

There are also various EU rules relating to consumer protection and financial services, which can have an impact on supplementary pensions (i.e. pensions other than pillar I), in particular individual voluntary personal pensions (so-called 'pillar III' pensions).

The European Commission also plays a role on pensions through the [Open Method of Coordination](#) which is a voluntary process for political cooperation based on agreeing common objectives and measuring progress towards these goals using common indicators. Fiscal sustainability, where the Treaty requires Member States to run budgets that do not jeopardise the functioning of the European and Monetary Union,⁵ can also bring pensions into play as they are typically a very significant part of government expenditure.

The advent of the European Semester⁶ has enhanced this. In every Semester so far, at least half of the Member States have had a pension-related Country Specific Recommendation (CSR) proposed by the Commission and endorsed by the Council. The European Parliament holds economic dialogues with the other EU institutions, e.g. on implementing the 'comply or explain' principle when adopting the draft CSRs.

Need for pension systems to be both adequate and sustainable

The **European Commission's** Green Paper for consultation, '[Towards adequate, sustainable and safe European pension systems](#)', notes: 'Adequacy and sustainability are two sides of the same coin. If pensions are at risk of being inadequate, there may be pressure for ad hoc increases in pensions or higher demand for other benefits, jeopardising sustainability. Equally if a pension system is unsustainable it will prove to be inadequate in the long run when sudden corrections are needed. The issues of pension adequacy and sustainability need to be considered jointly.'

The Commission's subsequent 2012 White Paper '[An Agenda for Adequate, Safe and Sustainable Pensions](#)' noted that recent public pension reforms would typically result in lower pensions (relative to pre-retirement earnings) in the future, albeit that poverty protection was generally maintained or improved.

Calls for more opportunities to save in occupational pensions

Against this backdrop, **the Commission's** White Paper noted that occupational and third-pillar pension arrangements were under-developed in many Member States, and called for enhanced opportunities for citizens to build up safe complementary retirement savings to help secure the future adequacy of pensions.

In 2011, the **European Parliament** adopted a [resolution](#) on the European Commission's Green Paper, which amongst other things, called for Member States to improve citizens' access to private savings schemes. It also called for the Commission to encourage Member States to facilitate participation in pillar II and to make proposals for promoting such a pillar where it does not yet exist. The resolution also stressed that diversification of pension income from a mix of public (first pillar) and work-related (typically second pillar) pensions, can provide a guarantee of adequate pension provision. In its [resolution](#) in response to the White Paper, the European Parliament recommended a multi-pillar pension approach consisting of combinations of the three pillars. It also stressed that the public (pillar I) pension either alone, or in combination with occupational (pillar II) pensions, should provide decent income relative to pre-retirement earnings.

The [OECD](#) recommends diversifying sources to finance retirement and encouraging complementary funded private pensions, with these including occupational as well as personal funded pension plans, normally run by private institutions.

The ETUC (representing trade unions at EU level) says 'Occupational pensions (second pillar pensions), based on collective bargaining, should be promoted'. And BusinessEurope (representing businesses at EU level) says 'Occupational and private pensions should be promoted to reduce pressure on state pension systems.'

The collective and not for profit nature of occupational pensions, together with the involvement of social partners may allow them to share risks between pension scheme members and to benefit from economies of scale, meaning lower costs per member.⁷

Current occupational pension provision in the EU

The current size and make-up of the pillar II (occupational) pensions sector varies considerably across Member States. Comprehensive and comparable data on occupational pensions in the EU are somewhat limited, including by definitional issues given the different systems in place. According to the European Insurance and Occupational Pensions Authority (EIOPA) Financial Stability Report 2015,⁸ the UK (55.9%) and the Netherlands (30.7%) account for almost 87% of the total occupational pension assets of the 21 EU and EEA countries they covered.⁹ Germany (4.5%), Italy (2.8%) and Ireland (2.4%) together account for close to a further 10%. Figure 1 shows the position in some Member States in terms of occupational pension scheme assets as a percentage of gross domestic product (GDP) in selected EU countries, based on OECD data.¹⁰

Coverage of the working age population by occupational pension schemes also varies with different approaches being taken. For instance, mandatory participation (e.g. Finland – almost 70% coverage), and quasi-mandatory membership (e.g. Denmark, Sweden and the Netherlands – all with coverage above 60%). The latter is achieved via industry-wide or nation-wide collective bargaining agreements, although these do not necessarily cover all sectors.¹¹ Voluntary systems also exist. The UK's automatic enrolment system is one such, but in order to boost coverage levels it has an inbuilt bias

to enrol people unless they actively opt out (programme still rolling out, but coverage over 50%¹²).

Coverage within Member States also varies (differently for different countries) according to factors such as sector, age, gender and type of employment. Apart from coverage, other important aspects for occupational pension schemes seeking to support overall retirement adequacy include contribution levels, the period of contributions, costs and investment performance.

Figure 2 shows the current split (by millions of euro in assets) of the occupational pension schemes falling under the [Institutions for Occupational Retirement Provision \(IORP\) Directive](#). This shows that DB

schemes are the most important with 59% of assets under management. DC schemes are the least important, whilst hybrid schemes (DB/DC) account for 35% of assets under management.

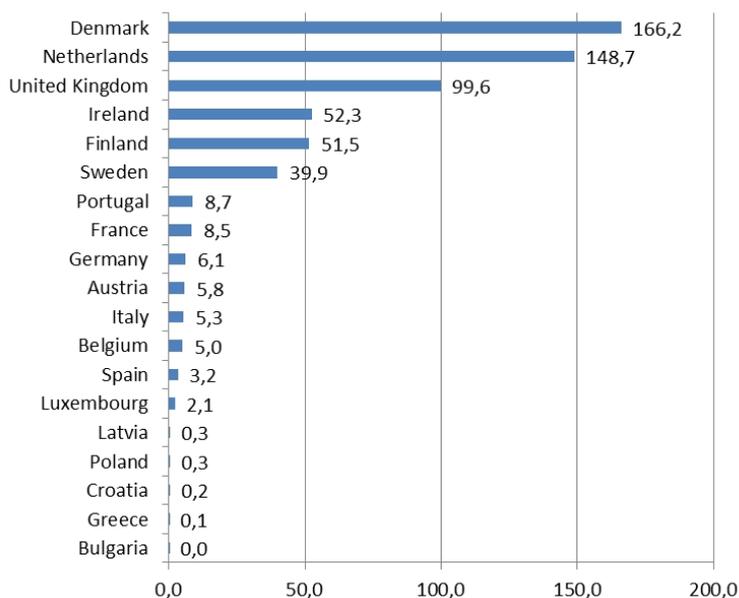
Prospects for maintaining and expanding occupational pension provision

Maintaining provision

Current occupational pension provision has come under pressure, in different ways depending on the system, from ageing demographics (including increasing longevity), the impact of the financial crisis and [lower interest rates](#). Pension funds have by and large weathered the financial crisis reasonably well. For instance, the OECD's 'Pensions at a glance 2013' says: 'Retirement savings took a hit in the initial phase of the global financial crisis but now pension funds' asset and solvency levels have largely recovered.' Nonetheless, some retrenchment has been seen, for instance in [Portugal](#) where

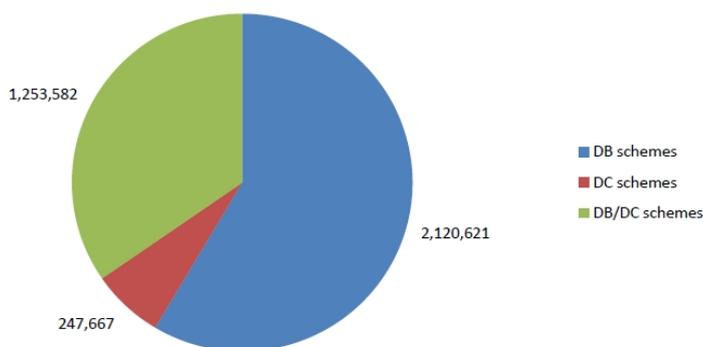
second pillar private pensions lost ground and some of their ability to compensate for the drop of pillar I replacement rates. In other countries, various actions to mitigate the

Figure 1 - Occupational pension plans' assets as % of GDP in selected EU countries



Data source: OECD Global Pension Statistics, 2013.

Figure 2 – Asset amounts by scheme type in million euros



Data source: European Insurance and Occupational Pensions Authority (EIOPA) [Market development report](#) on occupational pensions and cross-border IORPs 2015.

full range of pressures have been seen, together with an increased emphasis on security and managing risks (see below for examples).

In some countries (notably the UK, Ireland and Sweden¹³) where DB used to dominate, there has been a longstanding shift to DC schemes for the future and this has continued. In contrast, Germany has managed to maintain DB provision, though, even here, there is the beginning of a debate on a greater role for DC (see below) and a [report](#) from 2013 already noted (page 5) the beginning of a shift towards more employee (rather than employer) contributions and greater use of DC, driven by tax breaks. Another country to stick with DB is the Netherlands where adjustment mechanisms built into the schemes (higher contribution levels, lower – or no – indexation in some years or even nominal benefit cuts in some cases) have been triggered in order to maintain funding levels. Some would argue these mechanisms mean that the Dutch system had a much less ‘strict’ DB character in the first place.

Retirement ages, contribution levels, indexation rules and rules on the accrual of pension benefits for future service have also been adjusted in some schemes to put them on a more sustainable footing for the future. In the Netherlands, for example, most DB pension plans moved to an average salary (salary over whole career taken into account, rather than ‘final salary’ – the, typically higher, end of career salary level) when calculating benefits. Furthermore, indexation of benefits and accrued pension rights became contingent upon the investment performance of the fund.

Measures to increase the security of occupational pensions and improve the outcomes for members have been made most notably in Ireland (albeit from a weaker starting point). Ireland strengthened funding standards (the amount of assets pension funds must hold) and regulatory oversight, as well as making changes to the protections available and asset-sharing priorities amongst all occupational scheme members where the scheme and sponsoring employer become insolvent. In the Netherlands a law improving the governance of occupational pension plans (the so-called *Wet versterking bestuur pensioenfondsen*) was adopted in July 2013 to reinforce the ‘professionalism’ of investment and internal controls, amongst other things. The Netherlands has also seen a trend for consolidation of funds mostly for efficiency reasons. According to a [report](#) the number of Dutch pension funds has reduced from over 1 000 in 1999 to 394 by the middle of 2013. In April 2015, the UK introduced a [charge cap](#) (maximum charge to cover costs that can be levied on pension fund investments) of 0.75% of funds under management for occupational schemes used for automatic enrolment. Cost remains an important issue elsewhere too. For instance in Denmark a [report](#) notes that a 2012 study found costs were 0.45% on average in 2011, but with a spread between 0.20 and 1.19%, and that importantly there was no correlation between charges and investment performance.

Efforts to increase the sustainability of pillar I (public) pensions by raising retirement ages and encouraging longer working lives, as have been made in many Member States, can also benefit occupational pensions. Through explicit links, or merely from trickle-down effects through setting expectations, this can impact on occupational pension retirement ages, with clear benefits for sustainability and adequacy. As the OECD puts it, ‘Postponing retirement simultaneously increases assets accumulated to finance retirement and reduces the retirement period that those assets need to finance.’¹⁴

Expanding provision

The expansion of occupational pensions, both within countries with existing provision and in particular in those that do not already have significant occupational pension sectors, has in general been muted, at least for now. This could be explained by factors such as the current economic climate which makes funding extra saving difficult, low interest rates and the need to support consumption for macro-economic reasons.

One example of significant expansion already underway is the UK's introduction of automatic enrolment, which seeks to increase the voluntary coverage of occupational pensions by requiring people to actively opt out of joining such schemes and making employer provision and contributions mandatory. Since roll-out began in 2012, the proportion of UK employees in a workplace pension scheme rose to 50% (in 2013), the first increase since 2006 and (as at March 2014) more than 3 million eligible jobholders had been automatically enrolled into pension schemes. Minimum contribution levels will also gradually rise as the programme rolls out, ultimately reaching 8% of qualifying earnings (i.e. the mandated amounts the 8% applies to) in 2018.

Another example of reform comes from Slovenia. According to a [country document](#), 'The new pension legislation (ZPIZ-2) from 2013 'significantly broadened the scope of employers who can enrol their workforce in a supplementary pension Also, there is no threshold (% of consenting workforce) which would act as an obstacle for enrolment; under the new legislation, workers who do not wish to be member of a pension fund organised by the employer have to provide a written statement of refusal'.

Occupational pensions can also become more important, without necessarily requiring specific new initiatives, as funds grow and mature. For instance in Sweden occupational pension assets administered by life insurance companies were SEK1 582 billion in 2011, an increase of about 50% since 2006 ([ASISP Country Document](#), page 10). Occupational pensions may also increase in *relative* importance as pillar I public pension systems become less generous, for example in France ([ASISP Country Document](#), page 11).

In terms of possible future expansion, in Germany, a [debate](#) has been started on a new social partner IORP (occupational pension) agreement ([Neues Sozialpartnermodell Betriebsrente](#)) with the objective of increasing the coverage of occupational pension schemes to those not currently in schemes. This agreement would allow social partners to develop and introduce stand-alone DC industry-wide pension funds separate from employers, who would contribute to the schemes but not incur any liabilities. It is envisaged that these schemes would offer some level of guarantee but this would not be backed by employers, but rather by a 'lifeboat fund'¹⁵ arrangement (PSVaG – Germany's pension guarantee scheme) in the case of the insolvency of the scheme.

Another example of preparatory work to expand occupational pensions comes from Ireland, where the Government is committed to 'reform the pension system to progressively achieve universal coverage, with particular focus on lower-paid workers'. Following an earlier [report](#) commissioned from the OECD, Ireland is currently considering options to [improve coverage](#) of pillar II (occupational) pension schemes, moving on from the existing voluntary system, by introducing a new supplementary workplace retirement-saving scheme.

Belgium has been looking to expand pillar II pensions, with the social partners in the lead. However, an [ASISP Country Document](#) (page 10) notes little progress has been made towards this goal.

Main references

[‘Occupational pensions “Second pillar” provision in the EU policy context’](#), Ron Davies, Library Briefing, European Parliament, July 2013.

[The 2015 Ageing Report](#), European Commission, European Economy 3/2015.

[‘An Agenda for Adequate, Safe and Sustainable Pensions’](#), COM(2012) 55 final, European Commission, February 2012.

Endnotes

- ¹ 15 Member States: Bulgaria, Croatia, Cyprus, Denmark, Estonia, France, Greece, Hungary Italy, Latvia, Poland, Portugal, Romania, Spain and Sweden.
- ² The average first pension as a share of the economy-wide average wage at retirement.
- ³ [Modernised co-ordination](#): Regulation (EC) No 883/2004 and Implementing Regulation (EC) No 987/2009.
- ⁴ Avoiding losses on [supplementary pension](#) where workers are mobile.
- ⁵ [Economic and Monetary Union](#) (EMU) involves the coordination of economic and fiscal policies, a common monetary policy, and a common currency, the euro. Whilst all 28 EU Member States take part in the economic union, some countries have taken integration further and adopted the euro.
- ⁶ [European Semester](#): Yearly cycle of economic policy coordination where the EC undertakes a detailed analysis of Member States’ programmes of economic and structural reforms culminating in proposing Country Specific Recommendations which are ultimately endorsed by Council in June each year.
- ⁷ E.g. ‘Privately managed funded pension provision and their contribution to adequate and sustainable pensions’, page 29, Social Protection Committee, 2008 speaks about the potential advantages of such schemes.
- ⁸ European Insurance and Occupational Pensions Authority (EIOPA) [Financial Stability Report May 2015](#) page 40.
- ⁹ Note these figures are preliminary and subject to major revisions and relate to occupational schemes covered by the IORP Directive plus funds for pillar 1b schemes (so they exclude for instance pillar II occupational pensions that fall under insurance regulations, which are significant in e.g. Sweden, Finland and Denmark).
- ¹⁰ This includes insurance based occupational pensions. Notes: (1) No occupational plans in CZ, EE, SK, LT and RO. (2) Data on occupational plans not available for HU, SI, CY and MT. (3) NL: Insured occupational plans missing; SE: Benevolent societies missing; PT: Collective insurance missing; DE, AT: Direct insurance missing; ES: Collective pension insurance plans missing; LU: Group insurance contracts missing; EL: Pension insurance contracts missing.
- ¹¹ ECD (2013), [Pensions at a Glance 2013](#): OECD and G20 Indicators, OECD Publishing.
- ¹² [‘Automatic enrolment Commentary and analysis: April 2013 – March 2014’](#), The (UK) Pensions Regulator, July 2014.
- ¹³ In the UK just 13% of the approximately 6000 defined benefit schemes covered by the Pension Regulators 2014 [‘Purple Book’](#) remained open to new members to join. The [Irish Pensions Authority](#) said in 2014 that the great majority of Irish defined benefit occupational pension schemes] are closed to new entrants. ASISP Swedish ‘Country Document 2013’ Page 10 notes that the four large sectoral occupational pension schemes remain, but they are no longer defined benefit and that today private-sector occupational pensions are defined contribution.
- ¹⁴ OECD (2014), [OECD Pensions Outlook 2014](#), OECD Publishing.
- ¹⁵ ‘Lifeboat funds’: pension schemes pay a (typically mandatory) premium to the lifeboat fund which covers the risk the pension scheme is unable to pay promised benefits, e.g. [Pension Protection Fund](#) (UK) and [PSVaG](#) (Germany).

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