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Briefing

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European Union pensions policy

SUMMARY

Although Member States have the primary responsibility for designing their pension systems, major demographic changes along with strong economic shocks make the case for updating the European Union's role as regards pensions.

The European Commission’s 2012 White Paper on pensions has been fundamental to this process. Describing how the European Union (EU) could best help Member States to provide pensions for an ageing population, it emphasises the need to address the objectives of adequacy, safety and sustainability together. It is plainly in line with the 'European Semester', the recently introduced process for monitoring economic policies and coordinating structural reforms in Member States.

Via the White Paper and the new policy coordination mechanism, two major policy orientations have emerged: balancing time spent in work and retirement, and reducing the gender "pension gap". At the same time, securing both the safety and the sustainability of pensions are at the forefront of the European Union's agenda. In the context of free movement of persons, pension rights need to be secured to protect EU citizens from insufficient financial governance or accountability, in particular in respect of occupational pension funds. Complementary retirement savings might also be supported at European level in order to ensure sufficient pensions for the coming generations.

This EU policy has given rise to extensive debate amongst stakeholders covering the issues of active ageing, gender gap, subsidiarity principle, financial sustainability, mobility of workers, etc. Nevertheless, broad consensus has arisen that in-depth reform of the retirement systems is needed everywhere in the EU.

In this briefing:

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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: Plans in which contributions are accumulated, invested over time and then used to pay pension benefits in the future. Most occupational pensions are funded.

Occupational pensions: Pension arrangements made by employers to provide income in retirement for their employees. As these pensions are job-related, their portability is often an issue (see supplementary pensions).

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

Portability: The right to transfer the acquired occupational pension entitlements when a worker changes jobs or retires to another Member State. This can be between different employers in the same or different occupational sectors, or between employers in different countries.

Private pensions: Generally built up through contracts with commercial insurers, private pensions may be based on contributions by employers and/or employees, often within group schemes. Individuals, including the self-employed, may also take out private pension insurance. Sometimes referred to as the 'third pillar'.

Statutory pension age or pensionable age: Age at which a person normally becomes entitled to retire.

Statutory pension: Often synonymous with 'public pension', 'state pension' (in some countries also referred to as the 'first pillar'). The statutory pension has various forms in the Member States and is funded from diverse sources (by the state, from current workers and employers' contributions).

Supplementary pensions: Often synonymous with 'occupational' and in some countries known as 'second pillar' pensions. The supplementary pension schemes are most often created by an employer or within an industrial sector for the benefit of employees. Supplementary pensions can be mandatory or voluntary, in which case they may be encouraged with fiscal incentives.

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) in pension schemes.

Demographic challenges and new financial constraints

Ageing Europe

People aged 65 or over represent a significant and fast-growing share of the EU population (17.8% or 90 million in 2012), particularly as the 'baby boom' cohorts reach retirement age and the number of prime working age people falls.

Member States will have to adjust their pension schemes to three new major demographic parameters: the baby boom transition, often called the baby bust, rising longevity and declining fertility rates.

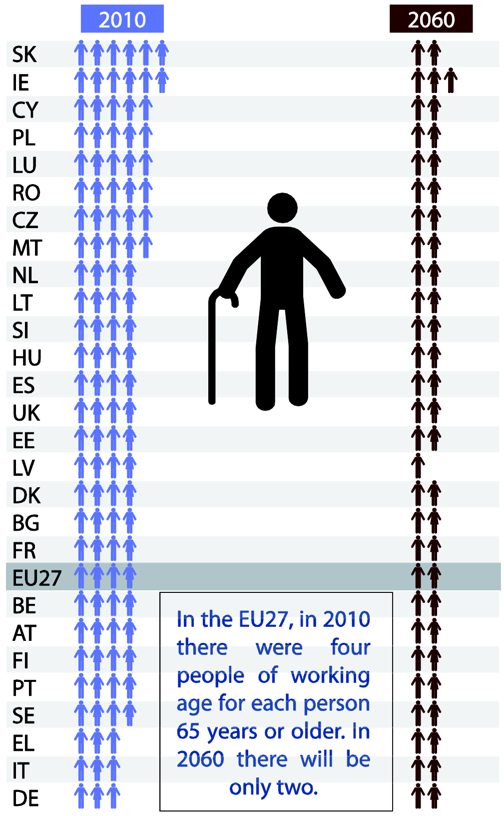
In 2012, there were four people of working age (15-64 years old) for every EU citizen aged 65 years or over. By 2060, that ratio will drop to two to one. There will be more people of pension age and fewer workers to help support them (see figure 1).

New financial constraints

The 2008 financial and economic crisis has worsened the impact of demographic ageing. While the crisis has affected pay-as-you-go pension schemes through falling employment, and hence decreasing pension contributions, funded schemes were also hit by falling asset values and reduced returns.

Many pension systems across the EU need some degree of adjustment in terms of adequacy and sustainability. Pension systems have to keep on delivering adequate pensions capable of preventing poverty and social exclusion amongst the older generations. They also have to meet the sustainability challenge. Pensions already represent a large share of EU public expenditure: 11.3% of gross domestic product (GDP) on average in 2010, possibly rising to 12.9 % in 2060. With spending on public pensions ranging from 7.5% of GDP in Ireland to 15.3% in Italy today, countries are in very different situations.[1]

Fig. 1: Old age dependency ratio (+65/15-64)



Data source: European Commission, 2012

A renewed EU pensions policy

The main responsibility for pensions remains with Member States (MS). However, the Treaty on the Functioning of the European Union (TFEU) requires the EU to support and complement the activities of MS on social protection (Article 153 TFEU) and to take into account adequate social protection in defining and implementing its policies (Article 9 TFEU).

The 2012 White Paper on pensions

In May 2010, the European Parliament called for a more comprehensive approach to EU pension reforms. The publication in summer 2010 of a European Commission (EC) Green Paper on pensions was a further initiative to launch debate on how and with which instruments the EU could best help MS to provide pensions for an ageing population.

Coinciding with the 2012 European Year for Active Ageing and Intergenerational Solidarity, and in line with the Europe 2020 Strategy, the White Paper "An Agenda for Adequate, Safe and Sustainable Pensions" proposed a range of policy measures to balance time spent at work and retirement and to develop complementary private and retirement savings.

EU new policy coordination of pension reforms

At the same time, the EU has reinforced its policy coordination as regards pension reforms through a new monitoring process and stronger coordination of structural policy reforms, which are closely connected.

EU's monitoring tools on pensions

- The EC has launched a policy follow-up though monitoring and peer reviewing MS' pensions policies. In May 2012, the Economic Policy Committee and the

Commission published the Ageing Report focusing on the results of the last decade of reforms, the impacts of the crisis and the long-term perspectives beyond the crisis (from 2010 until 2060). A new report is scheduled for 2015.

- In cooperation with the Social Protection Committee, the Commission presented the first Pension Adequacy Report (2010-50), showing that many reforms will result in lower statutory pensions in the future to ensure that public pensions remain affordable. A new publication is scheduled for 2015.
- In the framework of the Europe 2020 strategy, the Commission has put on-line a thematic summary on the Adequacy and Sustainability of Pensions. The summary includes an overview of the key indicators of pension adequacy and sustainability in MS.

Country Specific Recommendations on pensions
With the Europe 2020 Strategy, and via the European Semester, both stronger coordination of national policies and a framework for examining pension systems have been established at EU level. The Semester process starts with the publication of the Annual Growth Survey by the EC, followed by the adoption of country-specific recommendations. The process aims to ensure that MS keep their budgetary and economic policies in line with their EU commitments (debt and deficit commitments under the Stability and Growth Pact, economic reform plans enshrined in the long-term growth and jobs targets in the Europe 2020 strategy).

In the first four Annual Growth Surveys (2011, 2012, 2013 and 2014), pensions are highlighted as a matter of increasing EU concern. The importance of preventing early exit from the labour market, removing fiscal disincentives to work for people of pensionable age, linking the age of pension entitlement to life expectancy, equalising the pensionable age between men and women, supporting the development of complementary private savings to enhance retirement incomes and addressing poverty risks for people in retirement are repeatedly flagged. Consequently, a majority of MS (from 15 to 17) have received country-specific recommendations related to their pensions' schemes within this period (see below).

Main EU pension policy orientations

Two major policy orientations have emerged concerning the link between pensions and the labour market: balancing time spent in work and retirement, and reducing the gender "pension gap".

Balancing time spent in work and retirement
To sustain adequate pensions as people live longer, the duration of working lives has to grow, more or less in line with life expectancy. In 2012 and 2013, 17 and 15 Member States respectively received country-specific recommendations on pensions, which primarily focused on ensuring people work for longer.

Following a range of pension reforms in recent years, 24 of the 28 MS (all except Belgium, Luxembourg, Finland and Sweden) have now established current or future increases in pensionable age. Denmark, Greece, Italy, Cyprus, the Netherlands, Slovakia and the United Kingdom have decided to directly link pensionable age to life expectancy in the future. Finland and Sweden have introduced a flexible pensionable age, where the benefit level increases in case of later retirement.

Despite the crisis, employment of older workers and effective exit ages have continued to grow or held up well in most MS. In 2012, the average annual employment rate of workers aged 55-64 in the EU was 48.8%, an improvement of 10 percentage points over the past decade.[2] At the same time, significant cross-country differences remain (e.g. Sweden 73%; Germany 61.5%; Greece, Hungary, Malta, Poland, Croatia, Belgium and Slovenia below 40%).

Reducing the gender 'pension gap'

There is a marked gender divide in pension income, housing and financial wealth. Women are more exposed to the risk of poverty, since they start their retirement with lower pension entitlements and fewer resources but tend to live longer. Consequently, they suffer not only from a 'pay gap' and a 'promotion gap' but also from a 'pension gap'. In the EU-27, there is an estimated 39%[3] difference in men and women's income after the age of 65 (more than twice the figure of the 'pay gap', 16%).

MS are taking measures to guarantee gender equality in terms of pensionable age: 26 out of 28 Member States (all except Bulgaria and Romania) already apply the same pensionable ages to men and women or have passed legislation bringing in gradual equalisation in the future. Romania is also close to passing legislation to that end. This is in line with the EU policy to tackle gender discrimination (Article 19 TFEU).

Safeguarding pensions and savings in the long term

In the framework of the Single Market (free movement of persons, services and capital), the EU has competence in respect of the regulation of certain aspects of pensions.

Improving the 'mobility' of pensions

Free movement of workers means that workers should preserve their rights when they move to another MS. Regarding pensions, EU rules on social security coordination ensure that a person's insurance record is preserved in each country where they have worked or lived. Every country where they have been insured for at least one year will pay them an old-age pension when they reach that country's national pensionable age. An Electronic Exchange of Social Security Information (EESSI) is being developed to help social security bodies across the EU to exchange information more rapidly and securely. To facilitate mobility vis-à-vis the rest of the world, the EU is also negotiating provisions on social security coordination with third countries.

Nevertheless, as regards supplementary pension schemes, obstacles to freedom of movement between MS and to mobility within MS remain. These obstacles relate to the conditions of acquisition of pension rights, the conditions of preservation of dormant pension rights and the transferability of acquired rights. After eight years of difficult negotiations,[4] a new directive on the acquisition and preservation of supplementary pension rights is due to be voted in plenary in April 2014. To improve the pension rights of mobile workers, the proposed directive specifies that occupational pension rights must be granted after no later than three years of an employment relationship and puts forward rigid standards to ensure that the pension rights earned by outgoing workers continue to be preserved (e.g. indexed against inflation) when they move to another MS. The directive would not however cover the portability of supplementary pensions.

Safeguarding occupational pensions

Concerning financial governance of occupational pensions, Directive 2003/41/EC on the activities and supervision of Institutions for Occupational Retirement Provision (IORP) lays down basic requirements for occupational pension funds and their supervision, including rules which oblige occupational pension funds to invest their assets prudently, in the best interest of members and beneficiaries.

However, there have been significant developments since 2003. First, the financial crisis has highlighted the need for sound governance of financial institutions and clear information to members and beneficiaries. In addition, ageing populations have increased the pensioner-to-worker ratio, and the need for more retirement savings and for strong occupational pensions systems. At last, there is increasing recognition of the need for long-term investment in Europe's economy, and occupational pension funds are among the largest institutional investors[5] in Europe. In this perspective, on 27 March 2014, the European Commission adopted a legislative proposal for new rules on occupational pension funds. The proposal aims at improving governance and transparency of these funds in the EU, promoting cross-border activity, and helping long-term investment. More professional management of IORPs is expected to improve investment outcomes, thereby leading to higher pensions or lower contributions. Greater transparency should provide scheme members with better tools to take informed pension savings decisions early on in their working life.

The proposal does not include a review of the existing quantitative solvency rules for occupational pension funds (the Solvency II Directive 2009/138/EC). Currently, the European Insurance and Occupational Pensions Authority (EIOPA) is carrying out detailed technical work on this issue. For now, no EC initiative is expected until the next European Commission takes office, according to Commissioner for Internal Market and Services Michel Barnier, speaking at the EC Conference on the future of pensions (Brussels, 26 March 2014).

Developing complementary retirement savings

Recent pension reforms mean that most workers entering the labour market today will most probably get lower pensions than previous generations. Working longer may compensate for some of the reductions but overall, each year of contribution will pay out less than today (OECD). People will therefore also have to save more and governments have a role to play in the promotion of cost-effective instruments for retirement savings. In April 2013, the European Commission carried out a public consultation on consumer protection in 'third-pillar' retirement products, analysing possible measures for improving information and protection standards for consumers regarding 'third pillar' pensions. The EIOPA has recently submitted a report to the EC opening the possibility of creating a 'European retirement product' in the coming years.

Stakeholders

European institutions

The European Parliament has been at the forefront of all the major issues relating to pensions, with resolutions addressing points such as the demographic challenge and solidarity between generations (2010), the long-term sustainability of public finances for a recovering economy (2010), the role of women in an ageing society (2010), the impact of the economic crisis on gender equality and women's rights (2013), and the on-going issue of portability of supplementary pension rights (2013).The European Economic and Social Committee voiced concerns in its 2012 Opinion on the White Paper, regretting in particular that the EC does not seek solutions for strengthening public pensions. In parallel, in its Opinion on the White Paper, the Committee of the Regions encourages a stronger social focus in the pensions debate.

International research community

Many research institutes and international organisations share the same concern as regards the future of pension schemes in Europe. In its recent report, *The Inverting Pyramid*, the World Bank states that the deep effects of ageing populations and the shrinking labour force on overstretched state pension schemes demand significant reforms. It concludes that public pension systems in Europe will have to prioritise the provision of basic pensions, coupled with measures to encourage longer working lives and individual savings.

The OECD shows that recent reforms of pension systems have helped to contain the rise in future costs resulting from ageing populations and increasing life expectancy. It also underlines that funded pension programmes managed by the private sector[6] are likely to play an increasing role in delivering retirement income. Moreover, privately managed pension assets will most probably play an increasing role in financial markets, notably as a source of long-term savings.

The Robert Schuman Foundation highlights the fact that retirement systems in Europe still differ greatly in the way they function, and in terms of their financial situation, more than ten years after the introduction of the 'Open Coordination Method' in social policy that was supposed to launch a process of 'convergence'.

Social partners

The AGE platform supports the social dimension of pension reforms and voices concerns about MS and the EU focusing almost exclusively on increasing pension expenditure and old-age dependency ratios. Older people are most often represented as a burden to society. Their contributions to national social security systems and their role in helping younger generations with their income and time in old age are mostly unrecognised.

BusinessEurope, the employers' organisation, considers tackling demographic change one of the five key challenges European economies and societies have to face. From this organisation's point of view, occupational and private pensions should be promoted, labour productivity should be increased as well as employment rates, including by working longer.

Conversely, the European Trade Union Confederation (ETUC) deplores the overall EC approach that focuses on the macroeconomic aspect of pensions and ignores their social purpose in the establishment of an inclusive society. It criticises the focus on just two solutions: putting back the legal pension age and enforcing subscription to private pension schemes.

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