The growing importance of voluntary pension systems in Europe

<u>Fiap International Seminar: Pension Systems in a changing world</u>

Santiago, the 16th of May 2019

Cross Border Benefits Alliance – Europe (CBBA-Europe)

CBBA-Europe is a growing EU advocacy federation based in Brussels, created in October 2017 and officially launched in December 2017, representing:

1) *Sponsoring Employers;*
2) *Benefits' providers (pension funds, insurance companies);*
3) *Financial industry (asset managers),*
4) *Experts (lawyers, professors, actuaries, big consultancies);*
5) *National and international associations or networks*

CBBA-Europe supports all those stakeholders willing to create cross border pensions within the existing legal framework (Institutional/Advocacy support)….

….And CBBA-Europe is working for a better legislation: going beyond the existing framework and create the pan-European pensions of the future!

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The growing importance of voluntary pension systems in Europe

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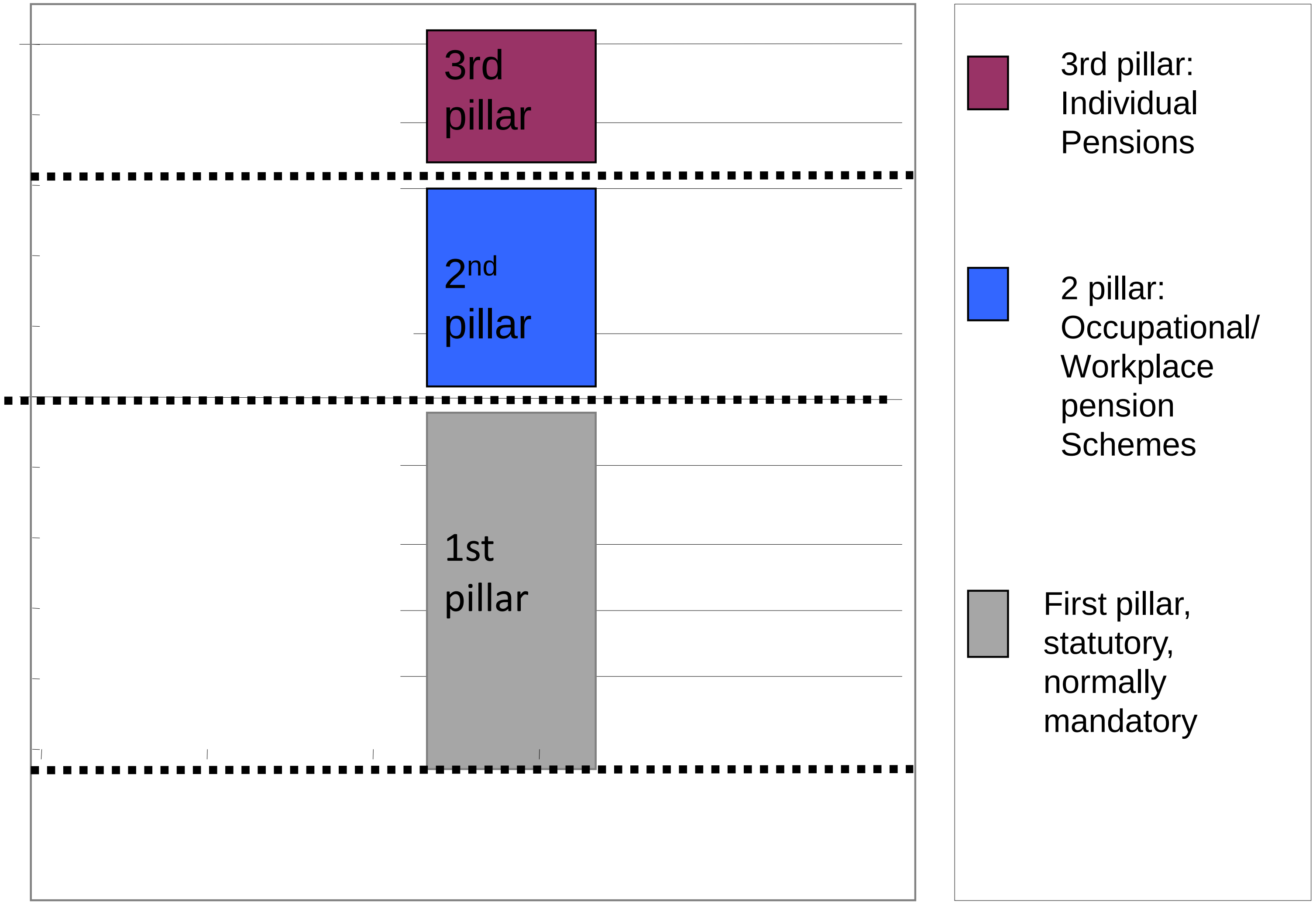
The “classic” structure of a pension system according to the EU terminology (different than Central Eastern Europe’s terminology!)



More in particular (following the traditional EU terminology):

3rd pillar

3rd pillar individual pensions: funded, DC, and voluntary, normally not financed by employer;

2nd pillar

2nd pillar occupational/workplace pensions, so co-financed by the employer: usually <u>funded</u>; sometimes voluntary, other times mandatory; DC or DB.

1st pillar

1st pillar pensions: statutory, normally mandatory by law ,and <u>Pay As You Go (PAYG) or tax financed: traditionally DB, but not always</u> (sometimes NDC; and other times flat rate/means tested)

Where is the real potential for a further development of voluntary pension systems in Europe, then?

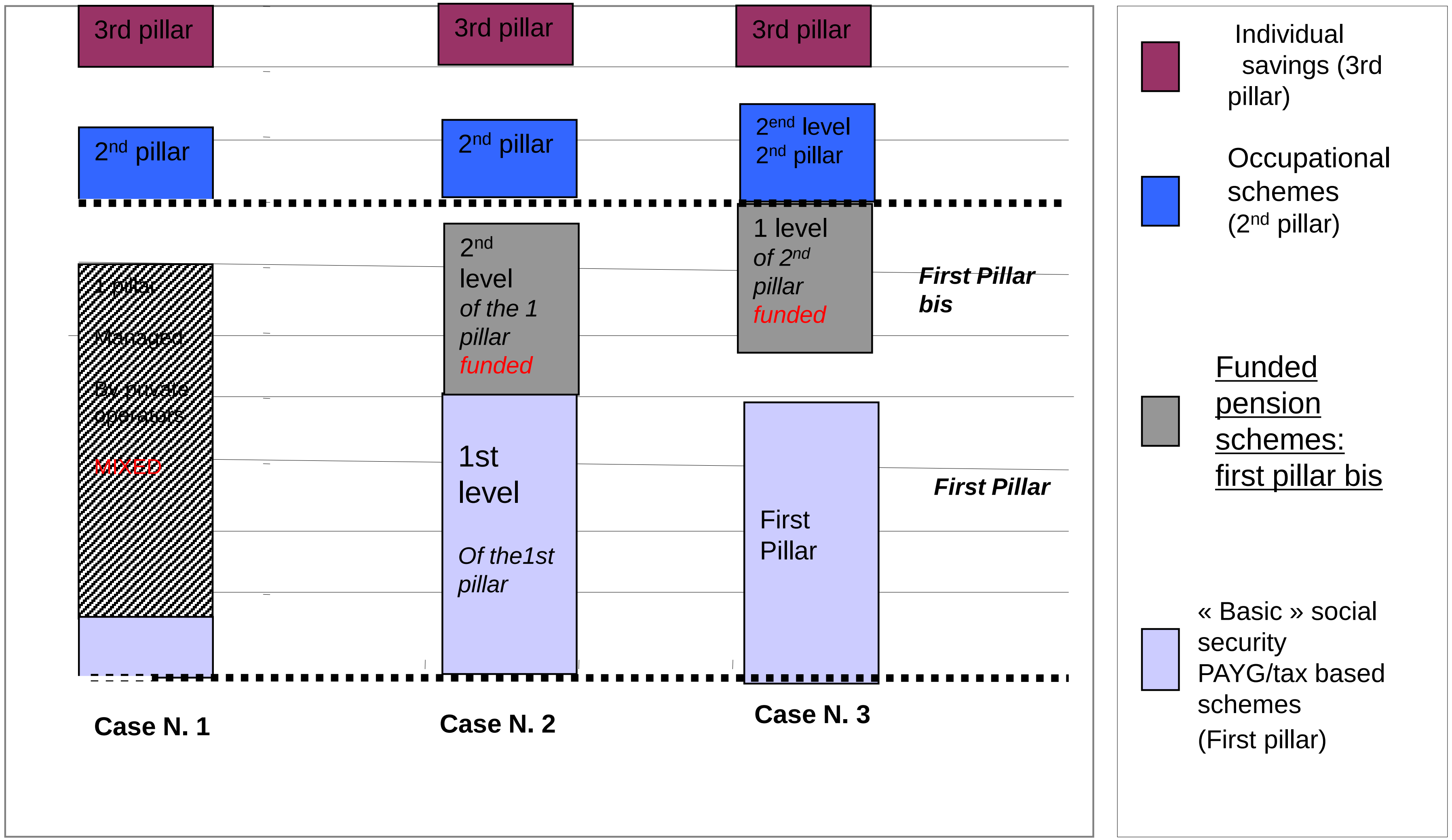
In principle, in the second and third pillar:

2nd pillar

3rd pillar

But with some other important exceptions…

Many EU Countries introduced a funded tier to their Pillar 1 (First pillar "bis")



European Countries with funded 1 pillar bis pensions

Case 1: Finland: mixed scheme 70% PAYG and 30% funded

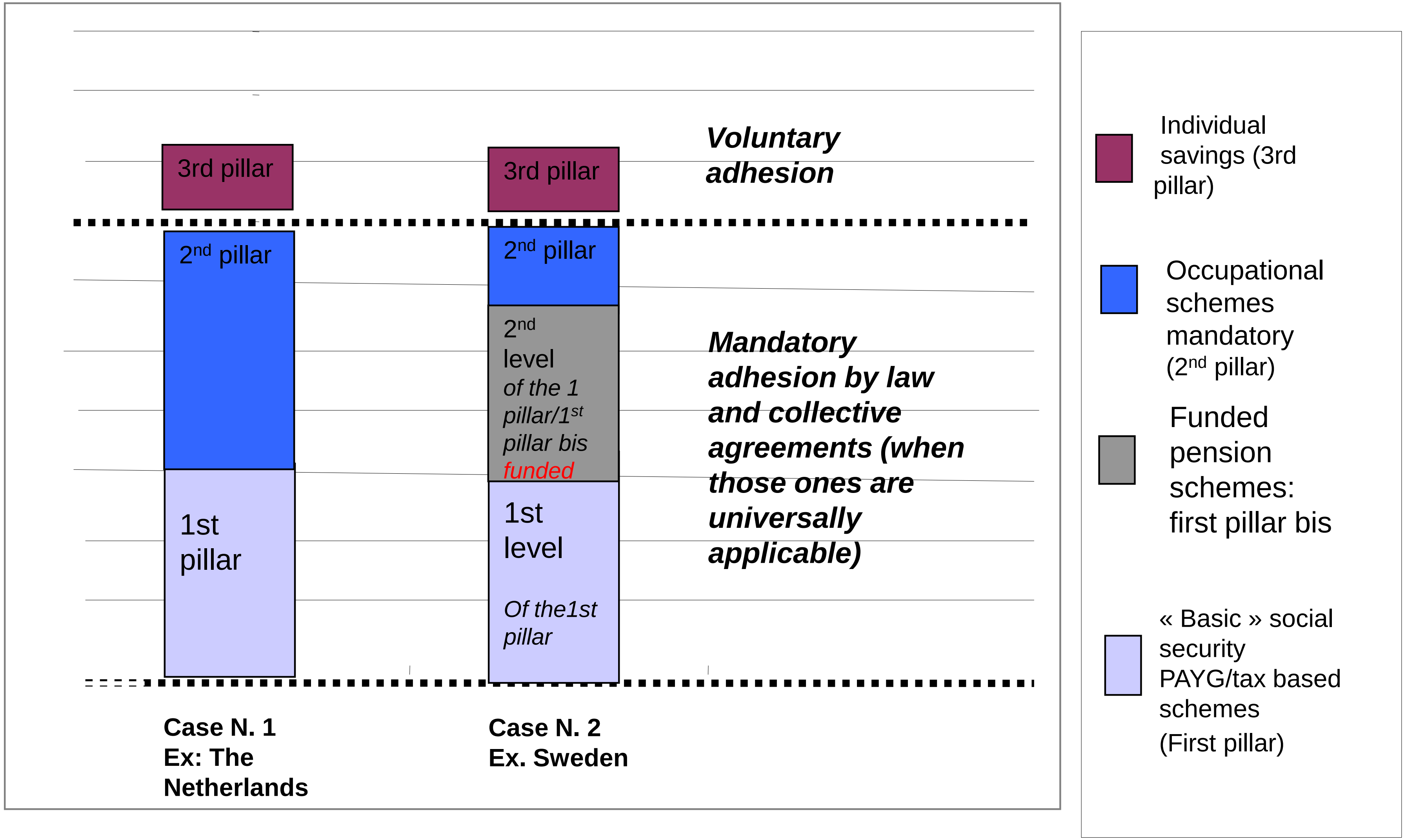
Case 2: Several Central and Eastern European Countries

(but Hungary and Poland nationalized their 1 pillar bis funded pensions, because of too big deficit of PAYG part; Romania at risk too);

Sweden and Denmark (their funded first pillar bis funded pensions have been added to the traditional statutory social security schemes)

Case 3: Switzerland (the 2nd pillar has a 1st layer, compulsory; the 2nd layer is voluntary)

Other EU Countries like the Netherlands and Sweden and, to a lesser extent, other states made their occupational second pillar mandatory (through collective agreements)



In Europe, it is now quite granted that a “mixed” pension system PAYG/Taxed based + Funded whatever the funded part ”falls” under the 1st pillar bis *1 pillar bis funded* or a mandatory second pillar 2nd pillar **is the best to combine:**

- **Sustainability;**

- **Adequacy;**

- **(And solidarity, both intergenerational and intragenerational still important** in the European tradition, even if more and more challenged in the current debates: case of the “young and rich” retiree grandparents and “poor working grandchildren”);

The main incentives/attempts to encourage funded pension systems in Europe

The main incentives/attempts to encourage funded pensions in Europe:

1) Tax incentives (and other social costs) **to join voluntary funded pensions for both 2nd and 3rd pillar;**

2) **Auto-enrolment into 2nd pillar pension funds;**

3) **Collective agreements favoring adhesion to 2nd pillar pensions;**

4) **Structural pension reforms of the first pillar introducing funded pensions;**

5) **Role of local/regional authorities to promote pension funds locally**

6) **New forms of compulsion to join 2nd pillar pension funds?**

7) **New EU Regulation on Pan-European Personal Pension (PEPP);**

1) The main incentives/attempts to encourage funded pensions in Europe:

Tax incentives

Almost all the European Countries grant a tax incentive when individuals and/or workers decide to join a private funded pension product:

- **Most widespread formula: EET** (tax Exempt on contributions; tax Exempt on investment returns; Tax on pension benefits); other formulas like ETT (Sweden, Italy; Denmark); or TEE (Luxembourg, Hungary, Czech Republic); or TET (Belgium, France, Austria), etc.
- In several Countries also **deductions on the employer's or employee's social security contributions** apply in case they offer occupational pensions;

2) The main incentives/attempts to encourage funded pensions in Europe:

Auto-enrolment into 2nd pillar pension funds

- **In case of no explicit refusal,** workers of the UK, Italy and (soon) Ireland are automatically enrolled into a pension fund (tacit consent);
- **According to this system, once that employees join the pension fund, employers are obliged to pay their contribution's part.**

Important differences apply among the 3 aforementioned Countries with regards to:

- the employer/employee contribution ratio;
- the possibility for members to withdraw part or the total amount of the accrued capital before the retirement age;
- the option of employer/employees to choose the pension fund;

3) The main incentives/attempts to encourage funded pensions in Europe: **collective agreements favoring adhesion to 2nd pillar pensions;**

- **A quite traditional habit in Europe** when social partners (employers and unions/working councils) negotiate about wages and working conditions of workers;
- **Occupational/workplace pensions often represent a part of those negotiations;**
- **Strong differences among the European member states according to their industrial relations systems** (negotiations level: national, sector-wide, regional, company; + legal force and extension: voluntary/compulsory).

Strong ind. rel.: Scandinavian Countries + Continental Europe (SE, NO, CH, BE, FR, DE, NL, IT);
Weak ind.rel.: Anglo-Saxon (UK, IRL), Central Eastern Europe; South Europe (apart from IT);

4) The main incentives/attempts to encourage funded pensions in Europe: **structural pension reforms of the first pillar introducing funded pensions;**

World Bank Model (end of 90's/2000's) in Central/Eastern European Countries (PL, HU, SK, LT, LV, RO, etc.):

- **First pillar pension contributions "split" between PAYG financed by employer and individual DC funded accounts** financed by employees (voluntary and/or mandatory depending on age): **1st pillar "bis" (called 2nd pillar in those Countries)**

- Goal: to **transform PAYG into mixed pension systems** (PAYG + funded);

- **Several challenges and further reforms** due to public deficit (PAYG partially deprived employees' funding) and financial crisis 2008-9 (huge investment losses): **funded part less and less mandatory, and mainly voluntary**

5) The main incentives/attempts to encourage funded pensions in Europe: **Role of local/regional authorities to promote pension funds locally;**

- **In Spain and Italy** (where local authorities have strong administrative powers) **some Regional Governments have financed:**
- **Creation of local/regional pension funds;**
- **Administration costs** of those pension funds;
- **Huge awareness campaigns** to convince their local citizens to join pension funds (local agents; contact and information points, radio campaigns);
- In some cases, **co-financing of contributions to pension funds on behalf of employees** (at least during a limited period);

Spanish Basque Region; Trentino Alto Adige; Valle d’Aosta; Veneto

6) The main incentives/attempts to encourage funded pensions in Europe: **forms of new compulsion to join 2nd pillar pension funds?**

- **Discussions and initiatives to make compulsory a participation to a pension fund,** either set up at sector-wide level (construction, metal, chemical sector, etc.), or by granting the possibility to choose other pension funds;

- The compulsion might be made possible **through new legislative initiative** obliging everyone to join a pension fund (maybe even a third pillar pension), or **by new extensions of sector-wide collective agreements** through public authorities;

- **Some Unions and Employers' organizations are favorable** (new dynamics of industrial relations: more labor flexibility in return for more employee benefits);

7) The main incentives/attempts to encourage funded pensions in Europe: **new EU regulation on Pan-European Personal Pension (PEPP);**

- **Last April 2019 the EU approved a new law providing for a new Pan-European Personal Pension Product (PEPP):**
- **It's the first "Federal" or "pan-European" pension vehicle, immediately operating in all the EU and fully portable across the States of the EU;**
- **Several features of the PEPP are already described by the EU law** ex. investment options; timing to shift from an investment line to another, etc. **(EU label);**
- **Fiscal treatment remains national** (equal to tax treatment of national 3rd pillar/individual pensions);
- **Clear EU political willingness to promote personal voluntary funded pensions,** especially in those Countries where second pillar (occupational) pensions are not developed;

Challenges making sometimes difficult to promote voluntary funded pensions in Europe

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Challenges to promote voluntary funded pensions (1/2)

The main problem of several EU Countries is that the PAYG component is too big (if not the exclusive), which is also very expensive:

- **In many Countries pension contributions cost more than 20% of wages** (Italy; France; Hungary; Poland; Latvia, Greece, Czech Republic, Spain, Austria, Portugal, Estonia, Slovenia, compared to a 18.4% OECD average in 2016);

- **Several European Countries spend more than the 10% of their GDP in public pensions** (Greece, Italy, France, Germany, Hungary, Austria, Portugal, Belgium, Poland, Slovenia, compared to a OECD average of 8,2% in 2013)

- **In some EU Countries, cost of labor is already very high**: additional contributions to pensions would be problematic for economic competitiveness;

- **Young generations** often earn less than their parents' ones, and they **do not have the financial means (or the awareness of the need) to buy voluntary pension products;**

Challenges to promote voluntary funded pensions (2/2)

- **Public financial incentives are also expensive,** and EU states have **high public debts;**

- In several European Countries, **awareness campaigns in favor of voluntary private pensions are not really launched by public authorities** (fear to spread out public fears and/or to face political unpopularity);

- Moreover, in some situations private pensions (especially individual/personal ones) revealed themselves to be too expensive (costs, fees) and with low returns: **reputational risk in many potential clients** (maybe the new PEPP will partially re-address this issue);

- In some Countries, the **assets of pension funds** (first pillar bis) **attracted the appetite of some Governments in need of money: high risks of mistrust;**

Conclusions:

1) In great part of European Countries where PAYG pensions prevail**, funded pension layers are definitely needed** (ageing of population, increasing demographic dependency ratio; low fertility rates);

2) **Several incentives and measures to promote funded pensions have been taken by the EU member states,** especially in the occupational (second pillar) pensions;

3) At the moment, **it seems that mechanisms like the auto-enrolment** (tacit consent), **involvement of trade unions (collective agreements), or new forms of compulsion work better** than mere tax incentives for spontaneous adhesions;

4) The new **EU PEPP initiative might strengthen the offer of voluntary personal pensions by creating healthier competition** towards several national personal pensions products (often too expensive and inefficient);

Conclusions:

5) The main challenges to new funded pensions (voluntary and/or mandatory) are twofold: **their further costs on wages -if** occupational/2nd pillar- **threatening the competitiveness** of EU companies; and the **difficulties for many young workers to afford costs** of voluntary pensions (low salaries compared to their parents' generation);

6) Moreover, often the **public debate does not disclose the gravity of the future pension issue: lack of awareness** that future pensioners will be not as lucky as the current ones;

7) Ideally, **contributions into current PAYG pensions should be reduced for young** people in order to provide them with some margin to pay into funded pensions: **but this operation is financially very risky** (easier to transform a funded pension into a PAYG scheme rather than the opposite….)

Conclusions:

8) Other option under discussion in some Countries: **to slightly reduce the current pensions under payment** (sometimes too generous in relation to the contributions previously paid) **and use these savings to finance contributions for young generations**: but strong opposition and legal issues about the "untouchable accrued rights";

9) **Young European generations seem to be much more in favor of individual pensions,** as opposed to "collective" or "intergenerational" pensions, because they feel cheated by their parents' generation;

10) **A strong cultural shift towards pensions should happen in Europe in the current scenario:** on the new role of the State, of employers/employees, and in particular of individuals in building up a retirement project; and on accepting radical pension reforms

THANK YOU FOR YOUR ATTENTION!

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