



aba Response Submission
(short version)

European Commission Green Paper

**Towards adequate, sustainable and safe European pension systems
COM (2010) 365/3**

The aba Arbeitsgemeinschaft für betriebliche Altersversorgung e.V. is the German industry association representing all matters concerning occupational pensions in the private and public sector. The aba has 1,400 members including corporate sponsors of pension schemes, pension funds, actuaries and consulting firms, employer associations and unions, as well as insurance companies, banks and investment managers. According to our statutes, our mission is to represent existing schemes as well as to expand coverage of occupational pensions independent of vehicle.

Occupational pension assets (including corporate assets covering book reserve schemes) in Germany totalled €453.8 bn in 2008¹. The most significant pensions vehicle is the direct promise with book reserves equal to €245.1 bn (54% of total assets) of which €142.2 bn cover pensions in payment and €102.9 bn vested benefits. Approximately 7.4 m employees in 2008 were entitled to either a current or future pension through a book reserve scheme. Assets of *Pensionskassen* totalled €107 bn (23.6% of total assets), support funds €37.1 bn (8.2%) and direct insurance €50.1 bn (11%). By the end of 2008 *Pensionsfonds* had accumulated €14.5 bn which represents 3.2% of total pension assets.

¹ Source: Schwind J. (2010): Die Deckungsmittel der betrieblichen Altersversorgung in 2008, in: BetrAV - Betriebliche Altersversorgung, Issue 4, p. 383f.

Introduction

The Green Paper focuses on the objectives of ensuring adequate, sustainable and secure retirement income for EU citizens. Collective occupational pension systems, especially, could play a larger role in achieving these goals:

Adequacy: If the aim is to maintain a specific replacement ratio in the face of declining state pensions – in order to avoid old-age poverty – supplementary provision that protects against biometric risks (old-age, death, disability) and is reliable (eg. exposed to limited market risk) is essential. Through the engagement of employers in the provision of supplementary benefits, pension provision can be collectively organized resulting in cost-effective and high-quality protection made available to employees.

Efficiency: The expansion of collective pension systems would be the most efficient and cost-effective option. From the perspective of the individual, occupational pensions are more transparent and less complex than private provision. Employer-sponsored pension arrangements do not represent competing businesses but rather function as part of a total pay package in the labour market. The pension package is an attractive benefit as the employee can take advantage of the buying power and expertise of the employer, risk-spreading across the workforce and lower administrative/acquisition costs than he/she could otherwise negotiate as an individual.

Security: Thanks to various 2nd pillar security mechanisms, employees and pensioners in Germany could rely on a stable and secure level of occupational pensions during the recent financial and economic crisis. There are many good reasons, both socio-political and fiscal, for focusing on collective pension systems.

The overwhelming majority of employees in the EU is not covered by supplementary pensions. From a social policy perspective, it is these people we want to reach. All future policy measures must be judged according to whether they contribute to expanding the coverage of occupational pensions. Employers and unions, supported by government, should take on this task.

(1) How can the EU support Member States' efforts to strengthen the adequacy of pension systems? Should the EU seek to define better what an adequate retirement income might entail?

The responsibility for pensions lies with the Member States. Retirement income systems in the various States have over the decades followed a very diverse path of development. The interaction between funded and pay-as-you-go elements as well as government, occupational and personal retirement provision varies greatly. Member States should continue to have "authority" over the organization of social security systems and remain responsible for the definition of adequate retirement income on the grounds that the regulatory, tax and economic circumstances are too diverse.

The EU should continue to support the Member States in their necessary but difficult social security reform efforts by facilitating the exchange of experiences, best practices and "learning from each other" through the Open Method of Communication (OMC). Moreover, the OMC could be utilized to analyse the 2nd and 3rd pillars of retirement provision in more depth. The title of the Green Paper containing the new aspect of "security" points in an important direction.

With respect to the aims of “adequacy and sustainability”, we believe that the quality of funded pensions is particularly important. A clear focus on collective provision, in which the individual is not alone subject to investment risk and important life risks (old age, death or disability) are covered, is in our opinion very important. Collective and work-place agreements could contribute to a high coverage rate of employees.

Most German IORPs can be characterised less in terms of “an integral part of financial markets” (p. 2 Green Paper) and more in terms of a social arrangement by employers.

“Broadening the sources of retirement income beyond pensions” (Point 3.1) is also a reasonable proposition, however, it is our opinion that the primary goal is to secure provision upon old age, death and disability. This cannot be achieved through every source of income.

(2) Is the existing pension framework at the EU level sufficient to ensure sustainable public finances?

The role of the EU should move towards ensuring that Member States have the incentives to manage their public finances in a consistent and sustainable way. This includes publishing statistics on all direct and indirect state pension obligations. The incorporation of these statistics into the public debt measures should be investigated.

The existing directives and regulations for 1st and 2nd pillar pension provision are in our opinion sufficient. 1st pillar pensions are covered by Reg. (EC) No. 883/2004 and Reg. (EC) No. 987/2009. These regulations have served us well for almost 50 years. Due to mutual recognition of social security systems in the EU, public finances are not affected by cross-border activity. Most 2nd pillar systems are regulated by the IORP Directive and the new EIOPA framework. The IORP Directive safeguards public finances by stipulating minimum standards for IORPs. In some countries (such as Germany) the additional safeguards of the employer covenant (Section 1 para. 1 sentence 3 Occupational Pensions Act) and insolvency protection system (PSVaG and security fund) contribute to the protection of public finances.

In connection with the stated aim of sustainability, it is important to point out that funding alone does not lead to general relief on public finances. If accumulated assets, driven primarily by regulation (see the insurance industry), are used to invest significantly in public debt, the debt servicing costs of this funding will simply again be met by the public purse. Funding must always be associated with value generating investments – financing public expenditure does not necessarily fulfil this criterion.

(3) How can higher effective retirement ages best be achieved and how could increases in pensionable ages contribute? Should automatic adjustment mechanisms related to demographic changes be introduced in pension systems in order to balance the time spent in work and in retirement? What role could the EU play in this regard?

In the face of an aging society, one possible method of sustaining public finances in a pay-as-you-go system and to ensure a sufficient working population, is to increase the state retirement age. The increase in the state retirement age should be transitioned over a sufficiently long period so that those affected, together with their employers, can ac-

commodate the later retirement. For reasons of subsidiarity, the EU should not play a role in this, with the exception of giving impetus to Member States through the OMC.

Increasing the participation rate of older workers will, among other factors, require a societal change of attitudes. Member States should review the financial incentives for older workers to retire early and the possibility of socializing the costs of early retirement (primarily in the social security system). Moreover, measures should be taken to help ensure the employability of workers over their entire working lives. There should also be more flexibility surrounding the transition from work to retirement.

A fixed state retirement age will lead to longer periods of pension payments as life expectancy increases. Without appropriate adjustments, this will lead to problems of sustainability and equity in pay-as-you-go pension systems. In light of this, the appropriateness of automatic adjustment mechanisms (p. 9 Green Paper) that increase the pensionable age in line with future gains in life expectancy, could be discussed in the context of the OMC. The implementation of policy, however, should be decided by the Member States. The experience over the last 10 years with the pension indexation formula in the German State Pension System does not speak favourably for the durability of automatic adjustment mechanisms.

(4) How can the implementation of the Europe 2020 strategy be used to promote longer employment, its benefits to business and to address age discrimination in the labour market?

Society needs a change of attitudes. Corporations and employees need to accept that the days of being able to retire early on generous benefits are behind us and that the challenges today are those of extending our working lives and employability. Member States need to meet these challenges and the EU can lend support through the OMC.

Moreover, we need to raise awareness that value must continue to be generated in Europe. Irrespective of how our pension system is financed (pre-funded or PAYG), a society whose members are largely in retirement, cannot function over the long term. It should, therefore, be possible to work even in old age. This does not mean, however, that the state pension age should be abolished. That would lead to the situation that employers would have to “pay-off” older workers in order to free-up positions.

There are many possible initiatives that would promote longer periods of employment and, therefore, a higher effective retirement age. These include:

- Improving job opportunities for older workers
- Improving employability of older workers through promoting health/fitness and life-long acquisition of skills
- Flexible retirement options
- Timely and reliable pension forecasts for employees performing physically or psychologically demanding work so that these develop realistic expectations of their future entitlements
- Abolition of an array of early retirement schemes
- Increasing the state pension age with a long transition period

In order to gain general acceptance for the necessary increase in the state pension age, effective communication by the government is essential. The EU can assist the Member States in implementing the Europe 2020 strategy.

(5) In which way should the IORP Directive be amended to improve the conditions for cross-border activity?

The internal market plays a minor role for the roughly 140,000 IORPs in Europe, in contrast to banks and insurance companies for example. Most IORPs have a very limited scope of operation, normally restricted to one or more sponsor companies or an industry segment. We consider an amendment of the IORP Directive, to facilitate cross-border activity, unnecessary at the current moment.

Should the Commission, nevertheless, suggest amendments to the IORP-Directive, then the question could be explored, whether from the perspective of multinational corporations, uniform regulations could apply to domestic and cross-border member segments of the same IORP. In the case of an amendment, the IORP Directive should, under consideration of the diversity of retirement systems in Europe, be restricted to laying down minimum standards and ensure that the administrative burden is reduced.

According to the Green Paper, the IORP Directive only covers funded occupational pension systems and “not even all occupational schemes fall under its scope (e.g. book reserve schemes are excluded)”. This is appropriate and should remain so, as the Directive defines supervisory regulation of EU minimum standards for IORPs. One cannot, however, conclude that schemes which do not fall under a national supervisory regime are any less secure. In Germany in 2009, we again witnessed that book reserves schemes coupled with an insolvency protection system can be a secure and attractive form of occupational pension provision.

We emphatically reject the introduction of a so-called 28th regime in addition to existing national occupational pension systems, as this can only take place outside of prevailing labour and social law. Reasonable policies for reform should be implemented within the existing systems and not outside them.

With respect to IAS 19, EFRAG should vigorously work towards ensuring that accounting standards do not have the effect of accelerating the decline of DB pension schemes.

(6) What should be the scope of schemes covered by EU level action on removing obstacles for mobility?

Portability in the sense of transferability of capital, and not of rights, is reasonable in principle and should be supported at the European level. “Portability” should not include minimum standards for acquisition and indexation of vested rights on change of employer. These should fall under national regulations.

When regulating transferability, the following points should be taken into account:

- The transfer should not negatively impact the existing schemes. Portability should, therefore, not lead to significantly higher costs and thus lower levels of provision.
- In order to avoid negative impacts, the transfer value should be calculated according to the rules of the departing scheme and converted into an equivalent benefit according to the rules of the accepting scheme. The transfer of capital can take place either immediately or when benefit payment(s) become due.

- It must be possible to allocate accrued capital to individuals. If this is not possible, the social partners should be prompted to develop a compatible and industry specific ruling on a voluntary basis.
- Small and medium sized employers with limited liquidity resources should be adequately protected as they cannot afford frequent and high capital outflows.
- The transfer of capital must defuse the liability i.e. absolve the departing employer of all legal liability.

In principle, all supplementary pension systems can be catered for if the above requirements are met. It should also be pointed out that transfers may not in all instances be the best solution for employees. Receiving meaningful and reliable disclosure prior to a transfer is, therefore, essential.

(7) Should the EU look again at the issue of transfers or would minimum standards on acquisition and preservation plus a tracking service for all types of pension rights be a better solution?

The EU and the Member States should again look at the issue of transfers (cf. Question 6). In contrast, minimum standards for the acquisition and preservation of pension rights should now and in future be left under the jurisdiction of national states.

In the Green Paper, the EU has recognized that the responsibility for all types of pension rights rests with the Member States. Considering the diversity of pension systems in the EU, meaningful harmonization in this area would not be possible. Each harmonization initiative would in fact increase the financial burden on existing systems and as a result negatively impact prevalence, adequacy and quality of these systems. In addition, one can ask the question why EU-harmonization should take place in the 2nd pillar when it is, in fact, not even aimed for in the 1st pillar.

In this context, we would like to point out that preservation of deferred benefits is very expensive and that it must be guaranteed in every case that former employees are not given preferential treatment to current employees (eg. which could be the case in non-salary related plans). Should higher minimum standards nevertheless be introduced, it must be ensured that they only affect future entitlements and have minimal impact on existing benefits.

Member States could review the feasibility of a domestic tracking service that would facilitate an overview of benefits that employees have accrued with various employers. These domestic organisations could then work together to help employees with accrued benefits in several Member States. The coordination could work in a similar manner to the 1st pillar system. Comparable internal projects at a single large enterprise show, however, that this, in principle, sound idea is very resource intensive.

(8) Does current EU legislation need reviewing to ensure a consistent regulation and supervision of funded (i.e. backed by a fund of assets) pension schemes and products? If so, which elements?

We do not see any issues with the co-existence of the IORP, Solvency II/Insurance and UCITS Directives in particular, that regulate different forms of saving and retirement provision – not even a “level playing field” issue. Most IORPs are socially oriented institutions in the first instance and less financial institutions. Socially oriented institutions are neither

comparable to life insurers nor investment funds. A uniform prudential and regulatory framework for all providers of retirement provision only makes sense if the retirement provision/products were uniform. EU regulation should continue to apply to providers and not to products. The general regulations for IORPs should exclusively be defined in the IORP Directive.

We believe it is important to make a clear distinction between “retirement provision” and other financial products. Perhaps the OMC could develop a common terminology for the concept of “retirement provision” as well as a demarcation between the various pillars.

We do not see a clear trend towards pure DC schemes considering that many Member States are trying to reduce risks for employees and sponsors through hybrid schemes (in Germany: *Beitragszusage mit Mindestleistung* [DC with minimum guarantee] and *beitragsorientierte Leistungszusage* [DB with DC characteristics]). The EFRP survey as mentioned in the Green Paper defines DC very broadly so that German defined contribution schemes with minimum guarantee are also included.

Considering the necessary cuts in national social security systems, it is questionable whether the further expansion of pure DC systems can be socio-politically justifiable without adequate quality standards. With respect to pure DC plans we believe that a heightened level of security for members and a review of the IORP Directive would make sense. In Germany we have found a good compromise with DC plans with minimum guarantee.

(9) How could European regulation or a code of good practice help Member States achieve a better balance for pension savers and pension providers between risks, security and affordability?

Security and reliability of occupational pensions have a high priority in particular for members. It is important to note that security mechanisms not only vary between the pillars of provision but also among 2nd pillar systems. As such even book reserve schemes coupled with an insolvency protection scheme can be a secure and attractive form of supplementary provision, as witnessed during the recent financial crisis.

In principle, it is important to find the right balance between risk and reward. In Germany we have found a good compromise with DC plans with minimum guarantee and the *beitragsorientierte Leistungszusage*. For socio-political reasons, we believe it makes sense for the IORP Directive to be reviewed with respect to the accumulation and payout phases of pure DC plans.

In other areas, a code of good practice is preferable to EU regulation. A clear focus on collective forms of supplementary provision is wise. Collective labour agreements on supplementary pensions and representation of members in IORP governing bodies could contribute towards a balanced relationship between risk, security and affordability. Risk management structures that are sound but tailored to the specific features of each IORP should be promoted.

It should be accepted, however, that occupational pension provision is, in principle, subject to risks such as longevity and capital market risk, among others, that cannot be fully eliminated. In reality, regulations such as IAS 19 for corporates or Solvency II for life insurers do not lead to benefit improvements, but rather to a shift of risks to beneficiaries/consumers. Life insurance products, for example, which transfer all risk to policyholders are exempt from capital adequacy requirements. Should a similar regulation be intro-

duced for IORPs, we predict an acceleration of the trend towards pure DC schemes for the reasons just mentioned. It is exactly this development that should be avoided for socio-political reasons (cf. Question 10).

(10) What should an equivalent solvency regime for pension funds look like?

Security and reliability are key to occupational pension provision. A variety of security mechanisms exist in the Member States to ensure that these objectives are met. Solvency standards for IORPs cannot, therefore, be discussed in isolation.

The prevailing quantitative requirements for IORPs in Germany, augmented by qualitative rules laid down in an appropriately adapted standard for risk management (MaRisk) are more than adequate, considering the employer covenant as an added security layer. Also, in the possible event of employer insolvency, the *Pensionsfonds* is covered by the PSVaG. IORPs, under existing regulations and supervision, have fared relatively well in the real-world stress test thrown up by the recent financial crisis.

Should the Commission, in spite of this, wish to review the solvency rules for IORPs, we would suggest building on the proposal put forth by the European Association of Actuaries, (GCAE). Considering the diversity of pension systems in the Member States and the role of national labour and social law in 2nd pillar provision, the GCAE proposes the adoption of 8 principles at the European level (see <http://www.ab-online.de/seiten/news/europa.shtml?navid=34>). Even the GCAE does not see a need for uniform capital requirements for IORPs and recognizes the inapplicability of the quantitative Solvency II approach. Instead, the GCAE prefers a holistic approach, which takes national characteristics into account. Full harmonization – such as the case of Solvency II for insurers – should not be the aspired target.

IORPs should be subject to solvency rules that are qualitative and risk-based in nature and respect their character as social entities with recourse to the sponsor in case of underfunding. The focus of solvency rules should, therefore, be on the long-term ability to meet obligations as they fall due rather than on mitigation of short-term fluctuations. The “Solvency II” rules do not fit occupational pensions.

(11) Should the protection provided by EU legislation in the case of the insolvency of pension sponsoring employers be enhanced and if so how?

In light of the diversity of labour, tax and prudential regulations as well as the economic environment in the respective Member States, a uniform EU-wide insolvency regulation or even regime is, in our opinion, not appropriate. Even the CEIOPS report “Note on Member States’ responses to the questionnaire on Pension Guarantee Schemes – PGS” dated 15 June 2009 outlines that the introduction of an EU-wide insolvency regime would be premature for the following reasons:

- Considerable diversity with respect to plan design (DB/DC) as well as supervisory rules and labour-/social law protection mechanisms;
- Hitherto limited prevalence of insolvency protection systems in the Member States. A general introduction of insolvency protection systems across Europe would be preferable to a harmonization of EU-wide rules;
- The introduction of any insolvency protection system should first be evaluated taking into account existing security mechanisms

- Increasing the cost of insolvency protection can lead to a reduction in benefits

Nevertheless, the EU study “The protection of supplementary pensions in case of insolvency of the employer for defined benefit and book reserve schemes” (p. 18, footnote 35, Green Paper), which the Commission initiated last year and has now been published, should be thoroughly reviewed and analysed.

Germany has strong security mechanisms. However, in view of the cross-border issues that can result from the diverse nature of national insolvency protection systems, we believe that possible improvements to the security of occupational pensions should be considered.

The EU can support the exchange of experiences, best practices and “learning from each other” through the Open Method of Coordination (OMC).

(12) Is there a case for modernising the current minimum information disclosure requirements for pension products (e.g. in terms of comparability, standardisation and clarity)?

Reliable and comprehensible information is a must in the sphere of occupational pensions. This applies even in the event that the beneficiary has no or limited choice. Only those who are informed about their level of occupational benefits can take responsible decisions on providing for their retirement.

Disclosure requirements should, however, not lead to complex descriptions or perhaps even disinformation. Unnecessary additional cost should be avoided. Uniform minimum standards should be limited to basic information such as the annual sum of benefits and contributions paid, returns credited, accrued and expected benefits, addresses of the pension provider as well as the relevant supervisory authority.

(13) Should the EU develop a common approach for default options about participation and investment choice?

Experience in Germany suggests that information about the necessity and potential of supplementary pensions has limits, which, in our opinion, are only in part of a financial nature. As there is general agreement that supplementary funded pension provision is necessary, the current widespread opting-in model (associated with high acquisition costs and low penetration) needs to be substantially improved. These discussions need to take place at national level however, and where appropriate, supported by the OMC. In the process, the pros and cons of automatic membership with opting-out provisions can be reviewed. In contrast, we do not believe that mandatory occupational pension provision is appropriate in Germany.

The question of whether default options with respect to participation and investment choice are appropriate and necessary significantly depends on the type of promise (DB/DC or hybrid) and the investment choices available to beneficiaries. The question of whether default options are necessary does not even arise in many collective occupational pension systems. In Germany, beneficiaries are involved in the choice of investment strategy through their membership of governing bodies.

The investments of a pension institution should be aligned with the specific risk profile of the respective liabilities (ALM). There is no need for further regulation of collective approaches, regardless of type of promise. In contrast, we believe it could be appropriate to review whether a common approach for default options on investment choice would increase the security for beneficiaries in those DC schemes that allow individual investment choices. Specifications should, however, not be too restrictive and leave sufficient room for national preferences. Imposing too restrictive rules risks the convergence to uniform products.

(14) Should the policy coordination framework at EU level be strengthened? If so, which elements need strengthening in order to improve the design and implementation of pension policy through an integrated approach? Would the creation of a platform for monitoring all aspects of pension policy in an integrated manner be part of the way forward?

We believe it makes sense to have an integrated approach with respect to monitoring all pillars of pension provision and retirement incomes policy in the respective Member States. The establishment of a new platform seems unnecessary to us, as one can leverage the existing instruments of the OMC i.e. intensify their use and develop them further.

If we want to jointly tackle the challenges posed by occupational pension provision in Europe, it is above all necessary to have access to comparative data. Decades of experience at Eurostat, the OECD and the EFRP show that the compilation of reliable statistics in this area is far from straightforward.

Moreover, the existing Pensions Forum of the European Commission should be enhanced as opposed to establishing a new platform. The Pensions Forum comprises experts from the respective national authorities, social partners and sponsors of occupational pensions. The members of the Forum have supported the European Commission for almost a decade.

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