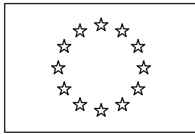

The Social Protection Committee

Privately Managed Pension Provision

Report by the Social Protection Committee

February 2005

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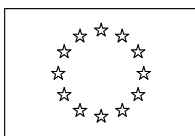

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1. INTRODUCTION

The SPC decided to launch this special study on privately managed schemes at its meeting on 19 February 2004 in order to describe their role in national pension systems and to assess their likely future contribution to adequacy as well as the financial sustainability of such schemes. The main purpose is to gather in a systematic way information on the current and likely future role of such provision in the Member States. This should allow to describe the make-up of national pension systems in a more consistent way in future national strategy and Commission services/joint reports and to highlight key issues to be addressed in the 2005 national strategy reports.

Several of the common objectives established in the Open Method of Coordination on pensions are directly affected by the role and development of private pension provision. The most important ones are objective 2 (allowing people to maintain their living standard), objective 7 (ensuring that private pension provision is adequate and financially sound) and objective 9 (adapting to more flexible employment and career patterns). The first objective relies on the two others: the contribution of private pensions to adequacy depends notably on whether assets are managed in a safe and efficient manner and on whether more flexible employment patterns leave workers the possibility to build up pension rights in these schemes.

Many pension reform strategies aim at promoting the development of privately managed schemes to maintain the overall adequacy of pension systems in a context of declining replacement rates from public, first pillar schemes. Indeed, replacement rates from first pillar schemes are projected to decline in many Member States in the future (cf. the study of the Indicators Sub-Group of the SPC on replacement rates). To prevent a fall in the relative living standards of pensioners, an increase of private retirement provision is envisaged in many countries (other important approaches to maintain adequate and financially sustainable pensions consist in encouraging workers to compensate for falling replacement rates by deferring retirement[1] and to reduce public debt – or build up public pension reserve funds – so as to make more budgetary resources available for future pension payments).

A number of Member States are therefore pursuing policies to increase the funded part of their pension systems. This can be achieved through mandatory membership or on a voluntary basis through collective bargaining and a regulatory and tax framework that favours the development of private pension provision and ensures the safe and efficient management of assets.

Privately managed pension provision is important to fill adequacy gaps left by cuts in public pensions, but is should not be seen as a panacea for the challenge of population ageing. First, it should be noted that both pay-as-you-go financed schemes and funded schemes are sensitive to biometric risks (increase in life expectancy). Any type of pension arrangement will have to adapt to increases in life expectancy by either reducing

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[1] "Promoting Longer Working Lives Through Better Social Protection Systems", Report by the Social Protection Committee, March 2004.

the amount of periodical benefits, raising the level of contributions or raising the age of retirement. Secondly, maintaining adequate incomes for an increased number of pensioners relative to the active population requires an increased share of GDP for the elderly and hence reduced consumption for the active. This is true regardless of whether pensions are paid by pay-as-you-go or by funded schemes as only current GDP (plus the difference between imports and exports) can be consumed in a given year. Finally, both pay-as-you-go and funded schemes are exposed to economic risks. Adverse developments in growth, employment and earnings reduce revenues in pay-as-you-go systems and hence the ability to pay current pensions;[2] in funded systems, benefits will be adversely affected by lower returns resulting from such trends and a possible imbalance between the supply of, and demand for, financial assets (total dissaving exceeding saving). Some of these economic and financial risks thus arise of course from demographic change itself which not only changes the balance between contributors and beneficiaries, but also between the number of people who save and people drawing down their savings. In ageing societies and at unchanged retirement ages, adequate pensions depend on the willingness to put more resources into pension schemes; this is true for both public and private, pay-as-you-go and funded schemes.

This report starts by presenting first of all the scope of schemes covered by the present study. The traditional distinction between 1st, 2nd and 3rd pillar is not very accurate. The diversity of schemes that can be found in the Member States means that there are many hybrid cases which are difficult to assign to a particular pillar. The study covers schemes from all three pillars: what they have in common is that they are run by private institutions and financed through separate funds, insurance arrangements or book reserves as opposed to institutions established by the legislator ('statutory schemes') and financed by social security contributions managed by public social security schemes.

In the next part, the current role of privately managed schemes in Member States' pension systems is described by looking in particular at current contributions of such schemes to the income of retired people, current coverage levels of active members and the level of assets held by such schemes. It should be emphasised that the importance of privately managed schemes varies greatly among Member States: as these schemes provide complements of income to pensioners (in addition to pay-as-you-go financed benefits), their importance is to a large extent a reflection of the size of public first pillar schemes which represent by far the main source of income for retired people. Moreover, in spite of the wide range of situations across Member States, some common issues arise, which are linked to the way in which risks are shared between the different actors. This relates in particular to the design of the types of scheme (defined benefit or defined contribution), to the type of benefits available (lump-sums or annuities) and also to the presence of redistributive elements.

The following part presents information on the future contribution of these schemes to adequacy and sustainability. Future benefits will depend on the available amount of assets which in turn will depend on several key parameters (e.g. coverage or contribution rates and effective returns on assets). Here again, even if the future role of these schemes differs greatly among Member States, several common issues arise linked to possible sources of uncertainties on the likely future contribution of those schemes. Examples are

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[2] However, some Member States plan to be in a position of increasing budgetary transfers to public pension schemes thanks to a decrease in public debt.

insufficient levels of contributions due to short-sightedness of active members or uncertainties regarding future rates of returns or administrative charges.

Finally, the last part stresses the key role of public policy intervention in the development of privately managed schemes. Such intervention takes many different forms and can be more or less direct. It includes making membership mandatory, providing tax or other financial incentives, defining prudential requirements and establishing the legal framework for collective or individual bargaining on pension entitlements. Good information plays a key role for the future adequacy and sustainability of privately managed schemes. A greater readiness of individuals to participate in such schemes requires a clear understanding of how they operate while for the public policy debate and the decision making process tools are required to monitor the development of privately managed schemes.

As a final point of this introduction it should be mentioned that harmonised international datasets do not cover in a comprehensive way the whole field of privately managed schemes in all Member States. Indeed, international data sources reviewed for this study do not provide complete information on the field of occupational and individual pension provision, both from the point of view of the schemes covered and of the number of Member States covered (see box).

Availability of internationally comparable data

Datasets available focus on a particular type of institutions managing private schemes. Some types of schemes are better covered (in particular occupational pension schemes using external funds), whereas information on others is very patchy (e.g. third-pillar individual provision) or almost non-existent in institution-based statistics (e.g. book reserve schemes). Moreover, most of the data sources do not cover all the 25 Member States (this is only the case for ESSPROSS and CEA data).

EUROSTAT data on pension funds cover occupational pension funds (excluding all insurance schemes, but covering individual schemes for some countries). The ESSPROSS database covers occupational pension funds (excluding all individual schemes) and first pillar schemes. These data are currently provided as aggregates without any breakdown by type of scheme. Some breakdowns could be envisaged in the future to distinguish public and private schemes.

OECD data cover autonomous pension funds (occupational or individual; in theory, insurance companies may also be included), while non autonomous funds (that are not legally distinct from the sponsors of the fund) are not covered (for instance book reserves).

CEA (*Comité européen des assurances*) data cover life insurance that may be used for providing lump sums or annuities or payments in the event of disability or death of the insured. However, data distinguishing pension plans from other types of policies are available only for new flows of contracts in the last years.

The European Federation for Retirement Provision (EFRP) compiles data on occupational pension funds (including book reserve schemes and excluding the second tier of first pillar schemes as well as individual provision). The geographic coverage does not include all the 25 Member States.

2. SCHEMES COVERED

This study covers privately managed pension schemes (either funded or book reserve schemes). Two broad categories can be distinguished. The first category includes collective provision through both occupational schemes and funded tiers of statutory schemes as exist in some Member States where the first pillar is divided in a first tier consisting in a classical pay-as-you-go scheme (in some cases with a reserve fund) and a second, separate tier consisting in a purely funded scheme managed by private

institutions. The second category refers to individual provision which is not related to employment and which takes the form of contributions to life insurance, pension funds or other forms of long-term savings.

2.1. Some shortcomings of the three pillar typology

The schemes covered by this study can fall into any of the traditional three pillars (cf. table): the 1st pillar (statutory pension schemes), the 2nd pillar (occupational schemes, that is pension schemes not established by law and where membership is linked to the employment status) and the 3rd pillar (individual provision, without any link to the employment status).

The boundaries between these three pillars are not always very clear and there can be different views on which pillar a particular scheme belongs to (notably with regard to the funded tier of the first pillar). It should also be noted that this classification is not embedded in EU legislation where the notion of pillars is absent from the definition of the scope of each of these instruments. From the point of view of European legislation, the first pillar coincides roughly with schemes covered by regulation 1408/71 which applies to statutory schemes (whether they include a funded part or not), but non-statutory schemes (established by collective agreements) can be included in the scope of this regulation. Directive 79/7 on equal treatment of men and women also applies basically to first pillar schemes, but recent jurisprudence by the European Court of Justice has ruled that its derogation concerning the retirement age and survivors' benefits do not apply to first pillar schemes of a clear occupational nature (public sector schemes). Directive 86/378 (amended by directive 96/97/CE) implements the principle of equal treatment for men and women in occupational social security schemes and hence concerns the second pillar; as does directive 98/49 which safeguards the supplementary pension rights of employed and self-employed persons moving within the Community (this protection concerns any voluntary and compulsory occupational pension scheme[3]). Directive 2003/41 on institutions for occupational retirement provision (pension funds) applies to schemes operated on a funded basis (excluding book reserve schemes and life insurance as well as schemes with a small number of members) and thus only covers part of the second pillar.

Moreover, while the three pillar terminology is widely used, it should be noted that these pillars can have very different meanings and sometimes also a normative content. Moreover, some classifications with more than three categories have also been proposed (cf. box).

Different possible classifications into three categories or more

Many different aspects have to be taken in to account in a classification of pension schemes, as for instance the way they are financed (PAYG - pay-as-you-go, funded or book reserves), the way they are established (by law, by collective agreement, by individual contracts), the way they are adhered to (mandatory or voluntary) or the type of benefit they provide (defined contribution or defined benefit). This results into a variety of possible classifications and one also has to take into account that many hybrid schemes exist (like partially funded ones, or with a mix of defined benefit and defined contribution provisions).

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[3] Article 3 of the directive defines as 'supplementary pension scheme' any occupational pension scheme established in conformity with national legislation and practice such as a group insurance contract or pay-as-you-go scheme agreed by one or more branches or sectors, funded scheme or pension promise backed by book reserves, or any collective or other comparable arrangement intended to provide a supplementary pension for employed or self-employed persons.

For instance, one can focus on the distinction between mandatory, statutory or voluntary membership as the main principle. In some Member States, membership is mandatory or quasi-mandatory: for instance for some funded tiers in the statutory pension scheme (as in EE, LV or PL for the younger generations or also in DK and SE for all generations) or for some occupational schemes (like in AT, DK, NL or SE). Membership can also be voluntary, resulting from a purely individual choice to become member of a scheme: this is of course the case for individual schemes, but it can also be the case for occupational schemes. Here again, it should be noted that some intermediate situations are possible, for instance voluntary membership can be the result of the option to opt-out from the mandatory PAYG financed first pillar (like in UK or LT), or there can be a silent assent mechanism of membership (like in IT for the new system of severance pay).

EUROSTAT's classification of pensions used in National accounts is based on the type of economic activity (i.e. which sector is principally responsible for which schemes) and makes a distinction between social security schemes and other pension schemes. In particular, EUROSTAT indicated in April 2004 that defined contribution schemes shall not be considered as social security schemes.

The World Bank uses a normative classification into three pillars where the first pillar is a relatively small, publicly managed, PAYG defined benefit pillar with flat-rate benefits, the second pillar is a privately managed mandatory defined-contribution pillar and the third pillar consists of voluntary, privately managed schemes based on individual accounts.

The ILO has a different classification into three broad categories: the first one consists of minimum pension guarantees that are universally available, means tested and financed directly from the general budget; the second one is a mandatory public PAYG social insurance scheme subject to a ceiling and the third one consists of fully funded defined-contribution schemes which may be privately managed and includes occupational schemes as well as individual ones.

It should be stressed that these last two classifications in three categories are mainly presented as models for pension system design and thus are of a more normative rather than descriptive nature. Indeed, they do not well integrate some important aspects of existing pensions systems, as for instance the financing aspects (which may rely on PAYG social security contributions, on general taxation or on contributions to a pre-funded scheme), or the type of benefits provided (universal, means-tested, earnings related, defined benefit or defined contribution), or the type of initiator of the scheme (statutory schemes, occupational schemes, individual schemes).

The OECD Directorate for Employment, Labour and Social Affairs is developing its own classification for pensions, which has to be consistent across the largest possible number of countries and to be based on descriptive terminology as opposed to some prescriptive model. The classification distinguishes notably between occupational and personal pension plans and between mandatory and voluntary membership. The OECD will be publishing a report on a 'Taxonomy of Private Pensions' in the near future.

Other classifications could also be proposed, implying different boundaries between the three main categories (pillars or tiers), or allowing more categories for the analysis (for instance the five categories used in last report of the French Council for pensions: a first category comprises means-tested schemes, a second one universal ones, a third one mandatory earnings-related PAYG schemes, a fourth one includes defined benefit occupational schemes, and the fifth consists of occupational funded defined-contribution schemes and voluntary individual schemes.

2.2. Categories used in this study

In view of this diversity of classifications it is particularly important to make explicit the range of schemes covered in this study (see table below): the first two categories of schemes covered here include funded tiers of statutory schemes and all occupational schemes (be they mandatory or voluntary), while a third category includes individual schemes (individual voluntary membership without a direct link to employment).[4] Thus,

[4] The choices made here rely in an important way on the information provided in the national replies to the questionnaire and especially on questions 1, 2.1 and 4.1 (role for compulsory membership), 4.2 (possibility to opt out of mandatory pillars) and 4.3 (role of collective bargaining).

this study covers basically all schemes apart from pay-as-you-go public schemes, which are the main source of income of pensioners.

Schemes covered in this study

Traditional classification	Covered in this study	Type of scheme	Examples
Statutory schemes (1st pillar)	No	Universal flat rate linked to residency	DK, NL
		Universal flat rate, funded by social insurance contributions	UK, IE
		Earnings related PAYG (with or without reserve fund)	Most Member States including ES, FR (Régime général, AGIRC, ARRCO), DE, BE, FI, LU, UK[5]…
	Yes	Earnings related, totally funded (by social contributions)	DK (ATP, SP and SAP Schemes), PL (OFE), LT (voluntary), LV and EE (mandatory), AT (BMVG[6]), IT (TFR), SK, SE (premium pension)
Schemes linked to employment status (2nd pillar)		Mandatory for employer (sectoral or cross-sectoral) or resulting from collective agreement (which makes membership mandatory)	DK (labour market schemes), PT (occupational schemes can be mandatory under certain conditions), FR (group insurance based occupational schemes), NL (occupational schemes can be mandatory, under certain conditions), SE , DE (at the request of the employee)
		Resulting from collective agreement (membership not mandatory)	BE (occupational schemes), DE (occupational schemes), ES (occupational schemes), FR (PERCO), IT (occupational schemes)
		Contractual or unilateral by employer (including book reserve or group plans)	AT (BBG), DE (deferred compensation), EL (occupational pension funds), IE (voluntary occupational plans), FI (occupational schemes), UK (occupational schemes)
		Possibility to subscribe to pension scheme through one's employer	IE (RACs and PRSAs), UK (Stakeholder and Personal pensions)
Schemes based on voluntary individual decisions (3rd pillar)	Yes	Voluntary schemes, with individual membership (no employment link is necessary to become member), that can be adhered collectively (for instance through associations or Unions)	CZ (Supplementary Pension Insurance), ES (Personal Plans), FR (PERP), SK (Supplementary voluntary plans) UK (Stakeholder and Personal pensions)
		Individual contracts with pension funds, life insurance companies or pension savings institutions	This type of individual provision is generally available throughout the EU.

2.2.1. Funded tiers of statutory schemes

As the aim of this study is to describe the role of privately managed pension provision, funded tiers of statutory schemes will be included in its scope. In EE, LV, LT, PL, SK, SE and also DK with the ATP scheme, the first pillar comprises a separate funded tier

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[5] The UK State Second Pension scheme is mandatory, but people can contract out into an occupational or personal pension scheme.

[6] The new severance pay scheme in accordance with the Occupational Retirement Provision Act (*Bebriebliches Mitarbeitervorsorgegesetz* / BMVG)

which is normally mandatory (except in LT where people can choose whether to pay the full amount of statutory contributions into the PAYG scheme or to divert part of it into privately managed funds (the second tier of the first pillar) which provide individual pension rights separate from those of the first tier of the first pillar (pay-as-you-go). Those funded tiers are included in the scope of this study. A special case is the new Austrian supplementary scheme (BMVG) which reforms the previous severance pay system: it is statutory (based on legislation) and defined-contribution. However, when the employment contract is terminated, the employee usually has the choice (irrespective of his or her age) between receiving the capital or investing it in special pension funds or some other form of supplementary pension provision which is favoured by tax rules. Whether this scheme is a pension scheme (occupational or personal) or a simple savings instrument depends thus on individual choices.

In some Member States (such as IE or to a lesser extent ES and FR), surpluses within the pay-as-you-go tier of the first pillar (or money coming from other sources such as the sale of mobile telephony licenses[7]) are placed in a reserve fund which will contribute to the financing of benefits under the pay-as-you-go tier of the 1st pillar. FI, LU and SE have large permanent reserve funds. However, these funds only back up the global obligations of the scheme and are not attributable to individual members. Such schemes remain publicly managed and are hence not included in the scope of this report.

2.2.2. Occupational schemes

Access to occupational schemes is necessarily linked to employment or occupation. Several main sub-categories can be distinguished, depending on the way in which the scheme is established.

- The scheme can be established by collective agreement, which can make membership mandatory for a sector or across several sectors; or it is a substitute for the 1st pillar (e.g. Portugal for the banking and telecommunication sectors).[8] This group includes for instance the quasi-mandatory occupational schemes in NL, DK and SE.
- The scheme can also be established by a collective agreement without making participation compulsory for employers and their employees. This group includes for instance occupational schemes in BE, DE, ES and IT.
- The scheme can be established by a company-level collective agreement.
- Membership in a scheme can be the result of individual contracts or of a unilateral initiative of the employer who can promise pension entitlements recorded in the company's balance sheet (book reserves) or offer coverage under group insurance contracts, or other contracts with pension providers (open pension funds).
- Finally, the employment status may give an employee access to certain types of pension provision that are not available to people outside the labour market (e.g. group schemes for trade union members).

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[7] In Ireland, surpluses from the pay-as-you-go scheme are paid into the Social Insurance Fund. Money from other sources, such as the sale of mobile telephony licences, is placed in a separate reserve fund which will contribute to the long-term financing of benefits from the pay-as-you-go scheme.

[8] When Member States chose to include these schemes in the scope of regulation 1408, mandatory occupational schemes functioning on a pay-as-you-go basis are not included in the scope of this report, but are considered as a part of the unfunded first pillar (this is the case for France).

2.2.3. Individual schemes

The category of "individual schemes" includes schemes for which membership is not required by law and independent of any employment link (even if members are mostly employed people). However, employers (as in SK) or the state (CZ) may in some cases contribute to the plan. Such schemes may also be adhered to through membership in an association (as is common in ES).

The main difficulty in analysing individual provision stems from the fact that it is difficult to distinguish among different types of savings those that are clearly for retirement purposes. Part of the savings that are not specifically labelled as pension savings may be used for retirement purposes, whereas part of the savings collected by retirement schemes may – depending on the rules of the Member State – in fact be used for other purposes than providing periodic retirement income (lump sums benefits, early withdrawal options). The extent to which these schemes are used for retirement savings depends notably on the conditions attached to them, e.g. tax incentives linked to the condition that the bulk of such savings must be used for a regular income (annuity) rather than for paying out a lump sum; another condition would be the minimum age at which a person can access such retirement savings.

In most countries savings in individual pension plans attract certain tax privileges. The widespread practice of EET[9] taxation represents a form of deferred taxation. It allows people to spread their income over their whole life. Under progressive income tax regimes this will typically have the net effect of lowering average taxation over the lifetime. This is because people will usually pay a lower marginal rate of taxation in retirement than in work (to the extent that their retirement income is lower than their previous earnings). In some Member States there are additional advantages for individuals saving for a pension such as exempting income used for pension savings from social insurance contributions or direct state support.

2.3. The role of social partners in occupational schemes

In most Member States, social partners play an important role in the overall pension system. The social partners may have a consultative or advisory role in the design of statutory schemes, sometimes formally recognised by legislation, even though they may not have the power to block legislative measures. In the case of privately managed pension provision and especially occupational pension schemes, social partners are the main actors, and pension matters are becoming an increasingly important issue in collective bargaining. Finally, in voluntary pension schemes, the main elements of pension provision are generally directly agreed between members and pension providers, even though social partners can also be associated, for instance through their participation in monitoring bodies.

In several Member States, occupational schemes are directly based on multi-employer collective agreements (BE, PT for sector-wide schemes, DK for 'labour market schemes', DE, IT, NL, SE for occupational schemes). In most countries, collective bargaining over occupational pensions can take the form of more decentralised specific employer-employee agreements. However, the decision to set up an occupational scheme can also be taken unilaterally by the employer at the firm level (DE, LU, IE voluntary

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[9] Contributions and investment income of the scheme are exempt from taxes; benefits are taxed.

occupational plans, FI occupational plans, UK occupational schemes). The UK government has, however, legislated in the 2004 Pensions Act to introduce a statutory requirement on employers to consult when they propose to make major or significant changes to future pension arrangements. This measure will ensure that employees who are affected active or prospective members of a scheme and/or their representatives will have the opportunity to give their views on proposed changes to their pension arrangements before the employer takes a decision. Finally, in some Member States, occupational schemes are not very common and individual plans or funded tiers of the first pillar play a more important role; this implies that collective bargaining is less important (e.g. CZ, EE, EL, LV, LT, HU, PL, MT).

3. THE CURRENT ROLE OF PRIVATELY MANAGED SCHEMES

The current role of privately managed schemes differs widely among Member States, with regard to the contribution to the total income of retired people, to levels of coverage of active members or to the levels of assets. However, in spite of this wide range of situations, Member States face some common issues which are linked notably to the way in which risks are shared in privately managed schemes. This refers in particular to the type of guarantee given on benefits (defined benefit or defined contributions), to the form such benefits can take (annuities or lump sums), but also to the extent to which these schemes include redistributive elements.

3.1. Diversity of situations among Member States

3.1.1. Contribution to the income of retired people

The overall contribution of privately managed schemes to the income of retired people reflects the level of contributions, the coverage of such schemes and their maturity (i.e. the proportion of pensioners with a full career covered by the scheme).[10] The current overall contribution to the income of retired people varies greatly among Member States. It is modest in a majority of Member States, but can be very important in a few ones where it can represent about a quarter or a third of the total income of retired people. In the vast majority of Member States, publicly managed first pillar pension schemes provide a dominant proportion of pensioners' incomes.

The Member States where private pensions provide an important part of the income of retired people (more than 20 % of income) are: DK (on average about 24 % of income before tax), IE (on average about 22 % of income), NL (on average about 34 % of income after tax) and UK (on average about 30 % of total income of retired people). In another group of Member States, the share of income coming from private pensions ranges from 5 % to 20 %: BE (around a quarter of net pensions, but only for the 20 % of pensioners are currently covered), DE (in 1999 about 6 % of pensioners' income from occupational schemes and 9 % from individual ones), FI (about 6-7 % of all pensions perceived), PT (about 8 % of pensions paid, but unevenly distributed across sectors) and SE (between 15 % and 20 % of total income of people aged 66 and more). Finally the contribution of private schemes is modest or almost negligible in a number of countries including ES, FR, CY, MT and LU, but the low level of benefits provided can also be

[10] Information on the overall contribution of privately managed schemes to the income of retired people presented here relies on the national replies to question 2.6 of the questionnaire.

due to the fact that such schemes have only recently been introduced as is the case in CZ, EE, EL, HU, IT, LV, LT, PL, AT, SI and SK.

One reason for a more extensive development of private pensions in some countries is the limited scope of income replacement of the public scheme. In some Member States first pillar benefits are flat rate; in others, they may be earnings-related but subject to a fairly low ceiling or offer only a low replacement rate for covered earnings. In these cases, private schemes have to contribute to an important extent to ensuring adequate replacement rates for pensioners.

3.1.2. Coverage levels

Achieving an adequate pension level will increasingly depend on access to private pension provision to supplement public pensions which will offer lower replacement rates. The proportion of workers contributing to a scheme gives an indication on the future contribution of privately managed schemes to incomes (this needs, however, to be considered together with information on the typical or average level contributions to, and benefits from, such private schemes). It is also interesting to compare coverage levels among groups (e.g. cohorts, age groups, socio-economic groups) and to consider the expected evolution of coverage levels (cf. 2.1).[11]

Coverage levels vary greatly among Member States.[12] Four main groups of Member States can be distinguished.[13] It should, however, be noted that figures for different types of coverage should not be added together; this can lead to double counting as people can combine different types of coverage. Only empirical survey data could give a clearer picture on which groups are covered by which types and combinations of pension provision. This underlines the importance of developing a comprehensive monitoring framework (cf. section 3.3).

A group with near comprehensive coverage (higher than 90 % of the workforce) includes DK (around 95 % of the workforce are covered by a scheme[14]), NL (around 90 % of workforce are covered by occupational schemes) and SE (about 90 % of workforce for occupational schemes and 50 % for individual schemes).

A group with high coverage rates (between 50 % and 90 % of the workforce) includes BE (between 40 and 50 % of the workforce for occupational schemes and, for individual

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[11] Information on the level of coverage presented here relies on the national replies to the questionnaire to questions 2.2 (active membership as percentage of working age population and of the population in employment) and 3.2 for the expected levels. It is important to recognise that coverage rates measure the proportion of people within a specific population who are currently contributing to a pension scheme. The proportion of people who will eventually receive a private pension may be higher due to the fact that some people may have ceased or not yet started contributions, for instance for reasons of labour market inactivity.

[12] They are generally less important for individual schemes, except in a few Member States, where occupational (funded) schemes are relatively less developed like CZ, ES, FR or FI.

[13] Coverage levels can refer to the population in employment or to the working age population. The use of a percentage of the population aged 20-64 is preferred as in some countries unemployed and inactive people can also be covered.

[14] About 68 % of 35-55 years old people are covered by occupational (employer managed) schemes, and among the remaining 32 % about 10 % are covered by an individual voluntary scheme, 6 % are dormant scheme members and 11 % are covered by the mandatory schemes ATP or SP.

provision, 25 % of singles and 60 % of couples), DE (about 57 % of people who are covered by the 1st pillar scheme are also covered by occupational schemes and about 13 % make individual provision according to the *Riester* legislation), EE (around 65 % of the employed population for the mandatory funded scheme and 12 % for individual provision), HU (about 58 % of the employed population are members of the funded tier of the first pillar and about 31 % have a voluntary pension plan), IE (about 52 % of the workforce, including occupational and individual schemes), PL (around 49 % of the workforce for mandatory and occupational provision), SI (around 53 % of the workforce is covered by occupational schemes), UK (43 % of the workforce for occupational schemes and 16 % for individual schemes).

A medium coverage group (between 10 % and 50 % of the workforce) includes CZ (around 40 % for individual provision), FR (around 10 % for occupational provision and around 8 % have subscribed a life insurance plans specifically for retirement purposes), ES (around 10 % for occupational and around 40 % for individual provision), CY (around 27 % of the population in employment for provident funds in the private sector and 13 % for occupational pensions in the public sector), LV (around 45 % of the employed population for the mandatory funded defined contribution scheme and around 2 % for individual provision), LT (around 42 % of the employed population for the statutory funded pension schemes and around 8 % for individual schemes), LU (around 17 % of the employed population for occupational schemes and 5 % for individual provision) and AT (around 35 % for occupational provision and around 10 % for individual provision), SK (about 27 % of the population in employment are covered by SPF schemes) and FI (around 7 % of 15-64 population for occupational schemes and 15 % for individual provision).

A low coverage group (less than or near to 10 % of the working population) includes: EL (nearly no coverage for occupational schemes), IT (around 8 % of the employed population for occupational schemes and 2 % for individual provision), PT (around 4 % of the employed population for occupational schemes and 1.5 % for individual provision).

The main indications on current coverage levels have been summarised in the table below. It should be noted, however, that this information is not harmonised and hence not comparable across countries (not least due to a lack of a common definition of individual provision and because data collection may be more or less comprehensive in the Member States). The purpose of the table is to provide a rough idea based on the replies received from the MS.

Estimates of current levels of coverage of privately managed pension schemes and their contribution to retired people income

	Coverage rates	Average contribution to retired people's income
BE	About 40-50 % for occupational pensions and for individual provisions	Around a quarter of net pensions, but only for the 20 % of pensioners are currently covered
CZ	Around 40 % for individual provision	Currently negligible
DK	Around 95 %	About 24 % of income before tax
DE	About 57 % of people covered by the 1st pillar scheme are also covered by occupational schemes and about 13 % make individual provision according to the *Riester* legislation.	About 6 % of pensioners' income from occupational schemes and 9 % from individual ones
EE	Around 65 % of the employed population for the mandatory funded scheme and 12 % for	For the mandatory funded scheme, first payments will be made in 2009; for voluntary

	Coverage rates	Average contribution to retired people's income
	individual provision.	schemes, the contribution is negligible.
EL	Nearly no coverage for occupational schemes.	No data available
ES	Around 10 % for occupational provision and around 40 % individual provision	No data available
FR	Around 10 % for occupational provision and around 8 % have subscribed a life insurance plans specifically for retirement purposes.	Around 3 % of the total pensions currently received
IE	About 52 % of the workforce, including occupational and individual schemes.	About 22 % of income
IT	Around 8 % of the employed population for occupational schemes and 2 % for individual provision	Currently negligible
CY	Around 27 % of the population in employment for provident funds in the private sector and 13 % for occupational pensions in the public sector	No data available
LV	Around 45 % of the employed population for the mandatory funded defined contribution scheme and around 2 % for individual provision	Currently negligible
LT	Around 42 % of the employed population for the statutory funded pension schemes and around 8 % for individual schemes	Currently negligible
LU	Around 20 % of the employed population for occupational schemes and 5 % for individual provision	No data available
HU	About 58 of the employed population are members of the funded tier of the first pillar and about 31 % have a voluntary pension plans	Currently negligible (less than 0.1 % of retired people's income)
MT	There are no occupational pension schemes or mandatory funded schemes in MT	
NL	Around 90 %	About 34 % of income after tax
AT	Around 35 % for occupational provision and around 10 % for individual provision	Very low (no data available).
PL	Around 49 % of the workforce for mandatory and occupational provision	For the mandatory funded scheme, first payments are not paid yet; for voluntary schemes, the contribution is negligible.
PT	Around 4 % of the employed population for occupational schemes and 1.5 % for individual provision	About 8 % of pensions in payment, but unevenly distributed across sectors
SI	Around 53 % of the workforce is covered by occupational schemes	For occupational schemes, payments have not started yet; for voluntary schemes, the contribution is negligible.
SK	About 27 % of the population in employment are covered by SPF schemes	Currently negligible (SPF created in 1996).
FI	Around 7 % of the population aged 15-64 for occupational schemes and 15 % for individual provision	about 6-7 % of all pensions perceived
SE	About 90 % of the workforce for occupational schemes and 50 % for individual schemes	Around 18 % of total income of people aged 66 and more
UK	43 % of the employed population contribute currently to occupational pension schemes and 16 % of the employed population contribute currently to personal pensions.	About 30 % of total income of retired people

Source: National replies to the SPC questionnaire.
Note: It should be noted that these figures are not harmonised and may therefore not be comparable across countries.

3.1.3. *Asset levels*

The total amount of assets held by private pension schemes is determined by average contribution rates, by coverage levels and the maturity of schemes. It represents a very useful indication of the importance of private provision and its capacity to contribute to older people's incomes. It also gives a good indication of the future importance of these schemes in the overall pension system.[15]

Current levels of assets vary significantly across Member States. The level of private pension scheme assets is modest in most Member States: less than 2 % of GDP in EE, LV, LT and SI, around 3 % of GDP in CZ, DE[16] and IT, around 4 % of GDP in AT and around 5 % of GDP in HU and PL (although it should be noted that private funded schemes have been introduced only recently in several of these countries and that asset levels are growing fast in several of these countries). It is close to or slightly above 10 % in five Member States (ES, CY, PT, SK and FI). In a few Member States levels of reserves are between one third and almost two thirds of annual GDP: around 35 % of GDP in BE, around 42 % of GDP in IE and 62 % in SE.

Estimates of current levels of assets of privately managed pension schemes

	Levels of assets (% of GDP)				Year
	Total	**Second tier of first pillar**	**Occupational schemes**	**Individual schemes**	
BE	37.0 %	//	17 %	20 %	2002
CZ	3.2 %	//	//	3.2 %	2003
DK	120.0 %	//	91 %	29 %	2003
DE	3.4 %	//	//	//	2002
EE	2.1 %	1.4 %	//	0.7 %	2004
EL	NA				
ES	12.4 %	//	8 %	4.4 %	2003
FR	3.0 %	//	3 %	//	2003
IE	43.0 %	//	//	//	2002
IT	3.0 %	//	2.9 %	0.1 %	2003
CY	13.1 %	//	13.1 % (a)	//	2000
LV	0.8 %	0.5 %	//	0.3 %	2003
LT	0.5 %	0.3 %	//	0.2 %	2004
LU	4.0 %	//	3.5 %	0.5 %	2004
HU	5.3 %	3 %	//	2.3 %	2003
MT	There are no occupational or mandatory funded pension schemes in MT				
NL	131.0 %	//	//	//	2001
AT	About 4 %	//	//	//	2004
PL	5.6 %	5.5 %	0.1 %	//	2003
PT	12.0 %	//	//	//	2002
SI	About 2.0 %	0.3 %	1.7 %	//	2004
SK	0.95 %	//	//	0.95 %	2003
FI	11.1 %	//	7.1 %	4 %	2003
SE	67.0 %	5 %	34 %	28 %	2003
UK	102.0 %	//	//	//	2001
//: not applicable or data not available					

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[15] Information on the level of assets presented in this section draws on the national replies to the questionnaire to question 2.4 (amounts of assets held by various forms of private retirement provision, as percentage of annual GDP), and question 3.4 (on the expected evolution).

[16] Data are only available for *Pensionskassen* and pension funds.

Source: National replies to the SPC questionnaire.
Note: It should be noted that these figures are not harmonised and may therefore not be comparable across countries.
(a) This level of assets refers only to provident funds; accurate data for the level of assets of occupational pension schemes in the broader public sector are not available.

Current levels of assets reach more than 100 % of GDP in only three Member States: 120 % of GDP in DK in 2003 (91 % for mandatory and occupational schemes and 29 % for individual schemes), 131 % of GDP in 2001 in NL and 102 % in 2001 in UK.[17] In some Member States, information on the level of assets is lacking and in many Member States, information is only partial, which again underlines the importance of developing comprehensive information and monitoring tools (cf. sections 3.2 and 3.3).

3.2. Benefit design and risk sharing

The design of benefits determines in particular how risks are shared between the different actors. This relates notably to the protection of beneficiaries against fluctuations on financial markets, against inflation and the types of biometric risks that are covered (longevity, invalidity, income protection for survivors in the event of early death). Finally, benefit design also determines the extent of redistribution within a scheme.[18]

3.2.1. Defined benefit vs. defined contribution

Schemes can be distinguished according to the type of guarantee they provide: defined benefit or defined contributions schemes or a mix of both elements. It should be noted that a shift from DB to DC schemes modifies the sharing of risk (biometric and financial): it reduces the risk for the scheme or the scheme sponsor (for instance the state or an employer) and increases it for beneficiaries (employees and their dependants). DC schemes generally provide individuals greater freedom of choice in the trade off between higher savings, later retirement and lower retirement income, although flexibility is also built into some defined benefit schemes.

The prevalence of defined contribution schemes appears to be rising as a result of recent reforms and trends in benefit design.[19] Indeed, pension provision in the new Member States is often of the defined contribution type (e.g. CZ, EE, LV, LT, HU, PL, SI, SK), while in the old Member States there has been a tendency for the share of defined contribution schemes to increase in response to changes in the economy, rising life expectancy or reforms (IT, AT, SE, UK). However, it should be noted that in some Member States, an important share of schemes remain of the defined benefit type (for instance in NL or in UK where DB schemes remain common particularly in the public sector). Moreover, there are also, in some Member States, some hybrid types of schemes where for instance a minimum rate of return is guaranteed (for instance in DK or BE) in a defined contribution scheme.

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17 According to the latest figures provided in the national replies.

18 Information on the type of benefits provided relies mainly on the national replies to questions 1, 2.1, 2.6 and 4.9 of the questionnaire.

19 This also applies to PAYG schemes with the introduction of notional defined contribution schemes in some Member States.

3.2.2. *Annuities and lump-sums*

Another important distinction deals with the type of benefits provided (lump sums or annuities[20]). Annuities insure against the longevity risk, whereas with lump sums there is a risk that the beneficiary will outlive the money that is available; on the other hand, any remaining money can be bequeathed. It should be noted that lump sums can be converted into annuities, but this remains at the initiative of the individual beneficiary.

Individual schemes provide most of the time either annuities or lump sums, even if in some Member States the part devoted to a lump sum is restricted either by direct legislation or by tax rules (like DE, IE, LU, HU, PT or UK). Lump sum payments represent the largest share of pay-outs in BE, CZ and ES, but are not common in NL, PT, SI and FI. Some Member States have introduced restrictions on the amount of retirement savings that may be taken as a lump-sum payment (e.g. IE, IT, LT or UK) and in other Member States, only annuities are available (like in LV, in PL the government prepares a law stipulating that the entire value of pension fund savings will have to be converted into an annuity). Moreover, in some Member States an increased use of annuities is expected (BE and CZ).

The possibility to choose between lump sum and annuity payments currently varies greatly among the Member States. A greater role of private pensions in securing adequate incomes in old age would call for more benefits being taken as annuities rather than lump sums. However, such a development (in particular in view of the shift towards defined contribution schemes) implies the development of institutions capable of delivering annuities. The private sector cannot yet respond to that need in all Member States as markets for annuities have yet to emerge.

3.2.3. *Presence of redistributive elements*

It should be noted that the principles of private insurance including freedom to contract, risk assessment and risk-related premium calculations leave no or very little scope for redistribution in contrast to social insurance which is characterised by compulsory membership and uniform regulations, allowing then a greater sharing of risks and income redistribution between individuals. Thus redistribution mainly takes place through first pillar schemes, be it through minimum income guarantees (which can also take account of income from privately managed schemes) or through benefit formulae which favour low income pensioners.

Privately managed schemes can nevertheless have redistributive effects (reducing or increasing inequality) through three main channels: namely through income tax provisions, the formula for calculating benefits and, finally, the degree of risk sharing they provide.[21] First of all, it should be mentioned that most countries support these

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[20] Annuities provide periodical payments to retired people (with insurance against biometric risks such as longevity and survivors' protection in the event of death, based on the use of life expectancy tables), while a lump-sum provide a single payment to the retired person in the form of a capital, leaving it to the beneficiary to ensure that this provides sufficient income during retirement. In some cases, pension funds can provide "phasing out" lump-sums payments: in that case, periodical payments are provided, but without any insurance against the longevity risk, that is progressively diminishing the available capital.

[21] Information on the presence of redistributive elements presented here relies on the national replies to the questionnaire to questions 2.7 (current provisions) and 3.6 (expected evolutions).

schemes through tax incentives: for instance tax deductibility of contributions or exemptions from social insurance contributions, but also lower rates of taxation of benefits and returns on investment. Although an EET tax system has the effect of deferring rather than avoiding taxation, tax incentives overall may have the effect of weakening redistribution depending on the specific tax rules of each Member State.

Defined benefit schemes can induce redistribution between beneficiaries, depending on the benefit formula that is used. For instance, pensions based on final salary (rather than career average) induce redistribution towards people who have advanced to higher pay-scales later in their careers. By contrast, defined contribution schemes are generally based on individual accounts and actuarial neutrality, excluding any redistributive elements. However, it should be noted that even if these schemes are contributory, they can include some non-contributory provisions, for instance by financing pension accumulation for periods of inactivity (this may be the case for both defined benefit and defined contribution schemes) or by providing survivor's benefits. For instance, in BE, "social pension funds" introduced in January 2004 integrate specific solidarity provisions: financing pension accumulation for some periods of inactivity (due to sickness, invalidity, unemployment), replacement income in the event of invalidity and providing index-linked benefits. Such schemes benefit from more favourable tax incentives and can also cover the self-employed. In AT periods of unpaid leave from employment (especially parental leave) are treated in many pension schemes as employment-equivalent periods giving raise to pension entitlements (but this is rarely the case with the defined-contribution pension funds which have become popular in the last few years). In PL, for mandatory pension funds (OFE), contributions for selected career brakes are financed from the state budget (this includes periods of maternity leave, child-care leave, periods of unemployment or of compulsory military service). In FI, in group insurance schemes, the employer has to pay higher contributions on behalf of those workers whose careers are shorter or who have fewer years to pay the contributions until retirement, allowing them to achieve an adequate level of benefits.

Finally, redistribution results also from the fact of not taking into account, in the determination of contributions and benefits, differences in life expectancy which may exist between men and women, professions, but also according to individual health status. Such redistribution occurs when benefits are paid as annuities; for instance, if the calculation of annuities is identical for all professions, this induces a redistribution from high risk professions to low risk professions. The use of unisex mortality tables induces redistribution from men to women to the extent that women enjoy a longer life expectancy than men; by contrast, redistribution from women to men would tend to occur in schemes with survivors' benefits which are more likely to be payable from a man's pension.

4. FUTURE CONTRIBUTION TO ADEQUACY AND SUSTAINABILITY

The future contribution of privately managed schemes to the income of retired people is expected to increase in a number of Member States, as a consequence of the increase of coverage rates and of the future level of assets. The future contribution of those schemes to adequacy and sustainability will then depend on the main parameters that influence the accumulation of assets, such as the levels and dispersion of coverage and of contribution rates and the level of real rates of return (taking into account inflation and also administrative charges).

4.1. Coverage rates and contribution rates: evolution and dispersion

4.1.1. Coverage rates

An important issue concerning the future contribution of privately managed schemes to the future income of retired people consists in achieving a sufficient coverage of the population. In that respect, it should be stressed that (except in three Member States) coverage rates currently do not exceed 50 % of the workforce (even less as a percentage of the working age population). In an important number of countries increases in the level of coverage are expected, though, as a result of the recent introduction of these schemes, which in some cases are mandatory.

In some Member States, schemes are mandatory for younger cohorts, so that the coverage is to reach 100 % within a number of years (e.g. EE, LV, HU, PL and SK). Moreover, an increase is also expected in some Member States where the coverage level is already high or very high, (e.g. IE, from 59 % to 70 % of the workforce aged 30 and over for both occupational and individual schemes, LT from 42 % to 60/70 % of the workforce for the funded tier of first pillar and from 8 to 10 % of the workforce for individual schemes and in NL from 91 % to about 95 % for occupational schemes). However, some Member States have not provided estimates on the likely increase in coverage rates (BE, CZ, DK, EL, ES, IT, AT, UK) and in some other Member States, no significant change is expected (e.g. FR, LU, PT, FI, SE).

The information provided by average coverage rates has to be supplemented by an analysis of the possible differences of level of coverage. Indeed, the presence of groups that may be at risk of insufficient coverage will limit the contribution of privately managed schemes to adequacy. Coverage rises notably with income and wealth which may be explained by several factors: statutory schemes typically replace a higher proportion of low incomes; the savings capacity of low-income earners is more limited and, finally, the value of tax incentives for private pension provision is usually higher for people on higher incomes.

While some Member States (e.g. DE) indicate a gender difference in the levels of coverage rates, it is interesting to note that in the EU as a whole no major differences in coverage between men and women are reported. Coverage rates are generally higher in big companies than in smaller ones. It should also be mentioned that in most Member States coverage and contributions levels tend to be low for people who are not in non-standard employment (for instance part-time employment or intermittent employment with frequent periods of unemployment). Moreover, higher job mobility can result in shorter periods of coverage and of contribution, as a result of the existence of long waiting periods (periods during which an employee cannot become a scheme member) and of long vesting periods (minimum period of membership/employment after which a pension entitlement must be recognised for an early leaver).

Another important observation is that in most Member States where data is available coverage levels are clearly lower among younger people unless membership is mandatory. These lower coverage levels for younger workers (for instance less than 30 or 35 years old)[22], for workers who are not in standard, full-time employment (especially

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[22] Information on coverage by age was provided by some Member States (CZ, FR, IE, IT, LT) and indicated that coverage levels are generally lower for younger people.

women working part-time) can represent a limitation to the future contribution of such schemes to the income of retired people, as the final level of accumulated funds (and therefore the resulting benefits) is very sensitive to the number of years of contribution and the level of earnings. Moreover, some types of occupational pension schemes result in lower benefits for frequent job changers due to a lack of portability of pension rights (this is an issue that is to be tackled by a forthcoming proposal for a directive on the improvement of the portability of occupational pension rights).

There is scant evidence at present of the other forms of assets held by people, which could be used to fund their retirement. Moreover, little is known about the distribution of ownership of such assets compared, for instance, to savings accumulated in privately managed pension schemes.

4.1.2. Contribution rates from active members and employers

The level of contribution rates to privately managed pension schemes gives an indication on the current relative importance of these schemes in the overall pension system and on the likely future benefit levels.[23] Levels of contributions to private pension schemes vary greatly among the Member States, reflecting the relative importance given to private pension provision. It should be noted that information on contributions levels does not appear to be extensively available and, for some countries, hardly any information is available. This is particularly the case for individual provision which can be difficult to define in a precise manner. Important information gaps also exist for occupational schemes. This underlines the importance of developing comprehensive information and monitoring frameworks (cf. sections 3.2 and 3.3).

In a first group of Member States, contribution rates are high and close to 10 % of gross wages. It includes DK (with a contribution rate to all mandatory or occupational funded schemes ranging from 9 % to 11 % and for individual schemes typically between 4 % and 7 %), CY (about 11.4 % of wages in so called *provident funds*), IE (with contribution rates ranging from 5 % to 20 % for DB schemes and of about 10 % to DC schemes), NL (where contribution rates have recently increased to about 15 % in order to restore buffers), SK (9 % of wages for the funded tier of the first pillar) and the UK (with typical contribution rates of 14.1 % of gross wages to DB schemes and 7 % to DC schemes).

In some other Member States, contribution rates range from 5 % to 10 % of gross wages: EE (6 % of gross wages for the statutory funded schemes), IT (9.26 % for new labour market entrants and 4.76 % for other workers), SI (typical contribution rate of around 6 % of wages for occupational schemes in the private sector) and SE (between 3 and 5 % of wages to occupational schemes, not including contributions added for DB schemes and 2.5 % of wages for the statutory premium pension scheme).

In many Member States the level of contribution rates is below or close to 5 %: BE (ranging from 1 % to 5 % for occupational schemes), CZ (around 2.7 % for the supplementary insurance schemes, taking account of individual, employer and State contributions), DE (for occupational pension schemes the maximum tax privileged contribution level is 4 % up to the ceiling for income covered by statutory pension

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[23] Information on the level of contribution rates from active members presented here relies on the national replies to the questionnaire to questions 2.3 (which refers to typical contribution rates and how contributions are shared between employers and employees), while expected evolutions were addressed in question 3.3.

contributions; for individual Riester-provision it is recommended to invest at least 2 % of the previous years' income subject to social insurance contributions so as to receive the full public support), ES (total contributions represent less than 1 % of GDP[24]), LV (currently 2 % of earnings for the statutory funded scheme; it is envisaged to raise this rate to 10 % by 2010), LT (currently 2.5 % for the State funded scheme; it is envisaged to raise this rate to 5.5 % by 2007), AT (around 1.5-2 % of gross wages for occupational schemes and around 0.8 % of GDP for life insurance), PT (around 3 % of gross wages for occupational schemes and around 2 % to individual provisions), FI (around 2.5 % for occupational schemes and around 3 % for individual provision).

Current levels of contributions into privately managed schemes and the share of employers' contributions

BE	Information on contribution rates for occupational schemes is limited. Rates appear to range from 1 % to 5 %. In occupational schemes employers typically pay 90 % of contributions.
CZ	For supplementary insurance schemes, the average individual contribution is around 2.2 % of the average gross wage (minimum of 100 CZK per month). Employers may contribute (currently this is the case for approx. 25 % of members with an average contribution of 410 CZK). A contribution is also made by the state and varies according to the member's contribution to the scheme (from 50 % for the lowest to a fixed amount of 150 CZK for the highest).
DK	Contributions for labour-market schemes (based on collective agreements) range from 7 % to 10 % of wages and salaries (higher in the financial sector and the public sector). ATP contributions typically amount to about 1 % of an average employee's income. SP contributions amount to 1 % of earned income. For individual plans, contribution rates amount typically to between 4 % and 7 % of wages. For labour-market schemes, employers contribute two-thirds of the sum, while the individual employee contributes one third.
DE	Employees can request their employers to convert part of their wages (up to 4 % of the income ceiling of the statutory pension insurance with an annual minimum of 181.13 € in 2004) into a contribution to an occupational pension scheme or life insurance. For individual plans, in order to receive the full public support, pension participants are recommended to invest at least 2 % (2004, maximum amount €1,050) of their previous years' income that was subject to social insurance contributions. This value will rise to 4 % in 2008 (maximum amount €2,100). For deferred compensation, the maximum publicly supported contribution is 4 % of the upper ceiling for statutory pension contributions (in 2004: 2,472 EUR). Contributions may be paid by the employer, the employee or both.
EE	For the second tier of the first pillar, the employer contribution is 4 % of wages (included in the total statutory contribution of 20 %); the employee contributes 2 % from wages. Those rates should remain constant.
EL	There are no data available yet, as no occupational pension funds are yet established.
ES	For 2003, contributions to occupational pension schemes amount to around 0.2 % of GDP. Contributions to personal pension schemes amounted to around 0.7 % of GDP. The sponsor of occupational schemes can pay contributions for employees. In 2003, around 93 % of the contributions have been paid by the sponsor of the pension scheme.
FR	No data on the level of contribution rates are available. The employer's contribution is typically exceeds that of employees'; the employers' share is generally 60 % for DC schemes.
IE	For Defined Benefit Schemes (not including public service schemes) contributions can vary from scheme to scheme. The employee contributes on average 5.3 % of earnings. In 2002, 85 % of

[24] Note that this is not comparable to the typical contribution rates reported by other countries where the total amount of contributions as a share of GDP can be very small, depending on the level of coverage.

	employers were paying between 0 % and 15 % of total pensionable pay into their pension scheme. These contribution levels have to be regularly reviewed. For defined contribution schemes, typical overall contributions are estimated at 10 % of pensionable salary which generally comprises equal employee and employer contributions. Recent research suggest that these contributions would need to be increased to 20 % if such schemes are to deliver adequate income in retirement.
IT	In 2003, workers contributed to occupational pension funds on average 1.17 % of their gross salary while employers contributed 1.18 %. New workers divert their severance pay provision (TFR) into pension funds (equal to 6.91 % of the gross salary), while old workers only divert part of their TFR, equivalent to the 2.41 % of their gross salary. As a result, total contributions paid by new workers are 9.26 % of the gross salary and 4.76 % by old workers.
CY	In provident funds, the average contribution of employees is 5.8 % and of employers 5.6 %. In occupational pension schemes of the public sector the employers pay all the contributions except for an average contribution of about 1% from employees for survivor's pensions.
LV	For the second tier of the first pillar, contribution rates are 2 % of members' gross salaries for the period 2001-2006 (18 % currently go to the first tier of the first pillar). This is to be increased to 4 % in 2007, 8 % in 2008, 9 % in 2009 and 10 % in 2010.
LT	2.5 percentage points from the 25.9 % statutory contribution is transferred to the second tier of the first pillar (these contributions come from employees' share). This fraction will increase by 1 percentage point each year to reach 5.5 % in 2007. For life insurance, the average contribution (2003) usually paid by the insured is around 0.8 % of average gross wage.
LU	For occupational pension schemes, no data are available; they are mainly financed by employers' contributions. For individual pension plans, the average yearly contribution for the most popular plans can be estimated at around 4 % of gross average wage.
HU	8 percentage points of the 26.5 % statutory contribution is transferred to the second tier (no change is expected). For individual plans, contribution rates vary widely and estimations indicate that the average rate is about 5 % of wages (of which two thirds are typically paid by employers).
MT	There are no occupational pension schemes or mandatory funded schemes in MT.
NL	For occupational schemes, the average contribution of private employers has risen from 8.2 % of gross income in 1997 to 14 % in 2004. Employers pay approximately 78 % of all contributions.
AT	For the new supplementary scheme (BMVG), the contribution rate is set by law at 1.53 % while for the traditional employer-run occupational schemes contribution rates are usually between 1.5 and 2 % (0.75 % for public sector employees). Employees can contribute (up to the amount the employer does) and this is actually common practice. In 2001, the total of life insurance premium income was around 2.8 % of GDP (contributions are totally individual).
PL	Contributions to the second tier of the first pillar are 7.3 % of wages (taken out of the overall 19.52 % statutory contribution rate). Statutory contributions are paid in equal shares by employers and employees. Contribution rates to occupational schemes are decided by the employer and employees when setting up the plan but cannot exceed 7 % of the workers salary. Almost half of plans have contribution rates ranging from 6 to 7 % of wages. Contributions are paid by employers and are exempt from social contributions. Employees can make additional contributions, but these are not exempt from personal income tax and social security contributions.
PT	Employer contributions to a defined contribution scheme usually amount to around 3 % of wages. Most of the time only the employer contributes, but employees do contribute in some defined contribution schemes. In 2002, only 2 % of the total amount of the annual contributions was affected to third pillar schemes (only individual contributions).
SI	For the mandatory supplementary pension insurance, contribution rates vary from 4.8 % to 12.4 % of the employee's gross wage, depending on the type of job the employee is performing (higher rates for high risk professions). In the collective supplementary pension scheme for public employees, contribution rates vary depending on the length of service of the employee. In the collective voluntary supplementary pension insurance for the private sector, the typical contribution rate is up to 5,8 % of gross wage of the employee.

SK	For the funded tier of the first pillar, contributions will be 9 % of gross wages. For supplementary pension funds, average contributions vary from 380 to 580 crowns for employees and from 400 to 440 SK Crowns for employers.
FI	Typically, contributions for supplementary pensions are paid only by the employer. For occupational group pension insurance employers usually pay the largest share of contributions (typically around 2 % of salary) and the employee's share of the contribution is less than 0.5 % of the salary. The average contribution for pension insurance policies is about 3 % of average gross salary (in 2003). This also includes individual pension schemes paid for by the employer.
SE	2.5 percentage points of the 18.5 % statutory contribution rate is channelled into the privately managed 'premium pension' scheme; 1 percentage point comes from the employee and 1.5 from the employer. For occupational schemes, contribution rates vary between 3 % and 5 % of wages. Employers pay 100 % of contributions. For individual plans, the average amount saved in 2001 was around 2.3 % of the average annual gross wage (totally individual).
UK	Typically an employer pays a contribution of 9.9 % in a defined benefit scheme and 4.3 % in a defined contribution scheme. The corresponding figures for employees are 4.2 % in a defined benefit scheme and 2.7 % in a defined contribution scheme.

Source: National replies to the SPC questionnaire.

Note: It should be noted that these figures are not harmonised and may therefore not be comparable across countries.

In most Member States, employers and employees make contributions to privately managed schemes. Employer contributions are generally higher in statutory funded tiers and occupational. The share paid by employers can very high: close to 100 % in SE (occupational pensions) or 90 % in BE and ES, around 80 % in NL and FI or around two thirds in DK (labour market schemes); it amounts to 60 % in FR or SE (premium pension). In some Member States, employers' and employees' shares are roughly equal (e.g. IT, CY for provident funds, second tier of the first pillar in PL). In other Member States, the sharing of contributions varies between schemes options; this is the case in DE, IE (variable for DB schemes, in DC schemes employers and employees typically contribute in equal proportions) or UK (on average employers contribute for 70 % in DB schemes and 60 % in DC schemes). Regarding individual pension provision, contributions are paid by the members themselves contribute, although in some Member States the employer or even the government can also make contributions (CZ, HU or SK).

It is important to consider total contribution levels and also the distribution of contribution payments by various groups (e.g. income group, profession, gender). There are generally no differences in contribution rates between different categories when schemes are mandatory. The Member States' replies to the questionnaire did not highlight major differences by profession or gender. However, it appears that the average level of contributions may increase with age in some cases (e.g. CZ, FR, IE, IT).

A key issue in relation to defined contribution schemes is whether the level of contributions made is sufficient to secure adequate levels of pensions. This is all the more important for Member States where privately managed schemes are expected to play an important role in the future adequacy and sustainability of pension systems. There is a risk of myopia which may result in younger individuals preferring current consumption and making insufficient contributions to pension schemes.

Some countries are already examining the role that private pensions and other forms of saving play in ensuring the adequacy and sustainability of pensions in the future. The UK has, for example, established an independent Pensions Commission to monitor and keep under review the system of supplementary pensions and long term savings. The

independent Pensions Commission published an interim report in October 2004, which argued that in order to maintain adequacy levels there would need to be an increase in pension savings and the participation rate of older workers. The report has initiated a wide ranging public debate in the UK. The independent Pensions Commission will set out its recommendations in autumn 2005. Recent research carried out in IE suggests that the level of contributions needs to be increased if the various schemes in which people participate are to deliver adequate pensions in the future.

Member States use mandatory membership in pension schemes (be they public and/or private) to varying degrees in order to address the problem of myopia. Such mandatory membership can be implemented through collective agreements between social partners. However, a move to mandatory membership will not necessarily increase total savings as it may result in reduced voluntary savings or increased debt contracted by households. In any event, when adequate pension outcomes rely in an important way on individual choice it is crucial to provide clear information to individuals on their expected level of pensions and on the level of savings that is required for an adequate pension (cf. 3.2).

4.2. Pension scheme returns

4.2.1. Rates of return

Levels of rates of return provide information related to Objective n° 8 (" Ensure (…) that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security"); they are especially relevant for efficiency and security aspects. However, there are difficulties in interpreting rates of return. Thus high rates of return could be an indication of efficiency, but they could also indicate a higher risk approach to investments. Regarding future rates of return, assuming lower rates would imply that more assets need to be accumulated to achieve a given pension level. Thus expecting low rates of return will reflect a prudent approach and imply higher safety margins in the pension scheme reserves.[25]

Member States' replies generally presented estimates of nominal rates of return. These have been translated into real rates of return using price indices provided by EUROSTAT.

The examination of Member States' replies shows an important heterogeneity in the level of rates of return both between Member States and within Member States for different types of schemes. Moreover, there are also important variations over time. For instance, recent evolutions of financial markets at the beginning of the decade generally translated into negative or low annual rates of return (see table below for some examples). Real rates of return have become positive again in 2003 (for instance about +3 % for individual provision in CZ, about 5 % in DK, about 5 to 7 % for the last 12 months known in August 2004 for EE, about 2.2 % in ES or 10.1 % in PL). A sharp drop in the value of investments held by a scheme would be particularly dramatic in the case of defined-contribution schemes for people who have to convert their accumulated capital into an annuity; for them, a drop in asset prices as occurred in 2000 would imply a dramatic reduction in their pension level. People can, however, respond to some extent to the risk of short-term fluctuations by choosing the moment of retirement, by deferring the

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[25] Information on the level of rates of return presented in this section is based on the national replies to question 2.5 of the questionnaire (rates of return typically earned, in % of assets, in different types of schemes) and to question 3.4 (expected evolution of levels of investment returns).

conversion of their assets into a pension and by shifting funds into less volatile asset classes as they come nearer to retirement (life-styling).

Investment risks: examples of low real returns in the recent past

BE		+1 % (1998-2002)
CZ		-1.1 % (1996-2003)
ES		-5.5 % (2001-2003)
NL		-11.9 % (in 2002)
AT		+1.2 % (1999-2003)
PT		-1.9 % (1999-2002)
SK		-2.4 % (1999-2003)
FI		+5.1 % (1998-2003)
SE:	occupational schemes	-11.8 % (in 2002)
	Premium pension investments	-33.1 % (between 2000 and 2003)

Source: National replies to the SPC questionnaire.

Note: It should be noted that rates of returns used here are real rates of return (nominal levels adjusted by the inflation rate) and that these figures are not harmonised and may therefore not be comparable across countries.

However, it should be emphasised that rates of returns should not only be observed over short periods of times. It is important to have a good understanding of what level of returns is realistic over the long term (several decades) as this determines the level of contributions that is required for an adequate pension. The technical rates of interest used for actuarial purposes must be based on a reasonable and prudent estimation of future rates of return. These are of course difficult to predict. Expected rates of return are provided only in very few replies by the Member States. DK indicates a rate of 6.5 % in nominal terms, NL around 2.5 % to 3 % in real terms (depending on the type of assets) and PL reports an optimistic 5 % in real terms.

Pension outcomes depend on rates of return over very long periods of time which may exceed half a century. Orders of magnitude of rates of return over the medium term have been provided by some Member States. For about the last decade, real rates of return generally ranged between 4 % and 6 % a year (for instance 4.0 % for the last decade in UK, 4.2 % in NL, 4.8 % in AT and 6 % in IE. The UK reported an annual rate of return of about 5.3 % over the last four decades (1963-2002).

Looking at past evolutions of rates of return over some three or four decades one finds that average rates are highly sensitive to the precise periods for which they are calculated and in particular to years of negative returns at the end of the period under review. The negative rates of return then apply to the entire stock of accumulated assets. Thus in AT, after the capital market slumps between 2000 and 2002, many pension promises were subject to cuts and in 2002 current pension benefits were reduced by about 10 % or even more in individual cases. Prudent management can reduce the risk to scheme members by shifting assets of people nearing retirement into less volatile investments.

This also raises the question of the right balance between return and risk for pension scheme investments. There is a trade-off: it may be possible to achieve higher average rates of return on pension fund investments, but this may come at the price of increased risks of negative returns. The purpose of pension schemes is to secure an adequate and safe income for a long period of one's life cycle. This also requires good protection against the risk of negative returns. In practice, this calls for an appropriate composition of assets (notably the proportion of stocks and bonds) and the adaptation of this mix to the circumstances of members (young vs. close to retirement).

It should be emphasised that the examination of the past evolution of rates of return shows that mean real rates generally range between 2 % and 5 %, and that yearly rates of return are subject to large fluctuations. This suggests that assumptions about future rates of return (which are needed to estimate future levels of pensions for a given level of contributions) should be chosen cautiously and that future pensioners should be made aware of the sensitivity of pension outcomes to alternative assumptions on rates of return, including possible years with negative returns (see also section 3.2). It is also important for future pensioners to understand how tax incentives can affect their effective (after-tax) rate of return. This after-tax rate of return will differ significantly depending on individual circumstances.

4.2.2. Administrative charges

Levels of administrative charges are also implicitly referred to in Objective n° 8 ("… that private and public-funded pension schemes can provide pensions with the required efficiency, affordability, portability and security"); affordability depends on charges being low as a proportion of assets or contributions.[26] Charges can be major problem especially for people with low incomes and hence low savings capacity as they are likely to represent a higher proportion of contributions or pension assets of people with small amounts of pension savings.

Administrative charges can be defined as including any type of cost (other than taxes) that decreases the real rate of return available for future pensioners. This includes charges for managing the funds, but also marketing costs which can be very significant. The level of administrative charges as a percentage of total assets provides the most direct indication of the impact of charges on real returns: this percentage has to be deducted from the real return on assets. Another way of measuring charges, particularly for newly established schemes with still low levels of reserves (and where charges can be expected to be higher as a percentage of assets), is to calculate the ratio of charges to contributions. This is also the way of calculating administrative charges for pay-as-you-go schemes where the level of charges is generally low due to economies of scale and to the absence of marketing costs and expenses for managing assets.

From the various replies provided by Member States it can be concluded that administrative costs generally range between 0.5 % and 2.5 % of assets per year; an average value of 1 % per year appears to be most representative. Costs tend to be lower for large collectives schemes due to economies of scale. Administrative costs are far from negligible, given that a reduction in the real rate of return by one percentage points leads to a considerable reduction in the pension level. Moreover 1 % of assets represents a much higher share of contributions.[27] This underlines the importance of policies aimed

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[26] Information on the level of administrative charges presented in this section is based on the national replies to questions 2.5 (importance of administration charges in % of assets and of contribution income), 3.4 (expected evolution of levels of administration charges) and 4.5 (policies to keep charges low) of the questionnaire.

[27] To illustrate this, let us assume that a person saves 100 currency units per year for 40 years. This means that after 40 years this person has contributed 4000 currency units (to simplify we assume that there is no inflation and that the real rate of return is zero). If administrative charges amount to 1 % assets per year the accumulated charges after 40 years amount to about 720 currency units. This means that the level of charges as a percentage of total contributions made would amount to around 18 %.

at keeping charges low. Thus, some Member States have introduced limits on the level of charges as a percentage of assets (cf. 5.1).

4.3. Likely evolution of assets and future contribution to the income of retired people

4.3.1. Level of assets

The total amount of assets reflects past contribution efforts and accumulated returns on assets. It provides an indication of the level of income that can be provided by private pension schemes. The total asset amount can also be used as an indication of sustainability: a higher level of assets for a given target level of pension benefits indicates a better level of financial sustainability.

When examining the projected evolution of assets, it should be kept in mind that the value of pension fund assets can fluctuate widely over a short period of time due to fluctuations in financial markets. This was the case at the beginning of this decade due to the slump on stock markets. The vulnerability to such fluctuations depends on the composition of assets and investment diversification. This should be considered at a later stage, based on the structure of assets by type of investment (which is available, for some Member States, from the OECD global pension statistics project).

In many Member States, asset levels of private pension schemes can be expected to increase, although few Member States provided estimates of future asset levels. Those that did reported that they expect the volume of assets to rise to a very high levels over the next decades (e.g. to a level of 40-50 % of GDP in LV over the coming two decades; to 63 % of GDP by 2050 in EE, 30 % of GDP in IT, 50 % of GDP in HU and 180 % of GDP in PL). In Member States where these levels are already high, the level of reserves could reach extremely high levels: in NL as high as 240 % of GDP by 2020 and about 300 % by 2040; in DK, by 2050, it would reach around 200 % of GDP for mandatory and occupational schemes and about 50 % of GDP for individual provision.

The envisaged future rise of funded schemes in a number of Member States implies a very significant increase in the level of assets as a percentage of GDP, but the heterogeneity of Member States can be expected to remain important. It would be interesting to develop a consistent framework for monitoring the current and future levels of assets which would notably allow to assess whether the resources of private schemes match the contribution to pension incomes that is expected from them(cf. 5.3).

4.3.2. Prospective contribution to the income of retired people

Achieving an adequate pension level will increasingly depend on private pension provision supplementing public pensions which, in many cases, can be expected to offer lower replacement rates in the future. An analysis of a country's future ability to meet objective 2 ("…enabling to maintain, to a reasonable degree, their living standards after retirement") therefore requires sound information on the current and future importance of private provision.[28]

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[28] Information on the expected level of contribution of occupational and individual schemes to the income of retired people displayed here relies on the national replies to the questionnaire to question 3.5.

In a number of Member States, the contribution of private schemes is expected to increase or to remain at its current level (see table below), implying that their relative role within the overall pension system will be significant (between 10 % and 20 % of retired people's income) or even very important (between 20 % and around 50 %) in most Member States. Nevertheless, it should also be stressed that even if the share of privately managed schemes is to increase in the future, first pillar PAYG benefits are clearly expected to remain the major source of income of retired people.

In most member States, a significant share of income is expected to come from private pensions (CZ, DE, IE, IT, HU, AT, FI). In some Member States, the share of pensioners' income coming from private pensions is projected to be between one third and one half and in a few cases even to become as important as, or even more important than the share of public pensions (DK, EE, LV, LT, NL, PL and UK) over several decades. In a few Member States the projected role of private pensions is to remain modest (ES, LU) and in some countries no information is currently available (EL, FR, PT, SE).

Estimates of future levels of coverage of privately managed pension schemes and their contribution to retired people income

	Coverage rates	Contribution to retired people income
BE	Participation in occupational schemes is expected to increase in the future.	An increase from current levels is expected.
CZ	Participation in supplementary schemes is expected to rise in the future.	The replacement rate from individual pensions is projected to reach at least 10 %.
DK	Participation in occupational schemes is expected to increase slightly in the future.	The share of privately managed pensions in retired people's income is projected to rise above 50 % in 2045.
DE	Participation in occupational and individual schemes is expected to increase in the future.	Occupational and private pensions together on average are supposed to replace an increasing proportion of gross income: 6.3 % in 2010, 10.3 % in 2030 and 12.8 % in 2050.
EE	Due to the fact that membership to the second tier of first pillar is mandatory for younger workers, coverage is expected to increase.	The second tier of the first pillar is expected to provide around 45 % of pension income in 2030.
EL	There are no data available yet, as no occupational pension funds have yet been established.	An increase from currently negligible levels is expected.
ES	An increase of the coverage of occupational pension schemes was expected during 2004, due to creation of a pension scheme for civil servants, raising the coverage to around 7 % of the employed population. Along with this, autonomous communities are promoting similar schemes, which will increase the total number of members by around 12 % of the employed population.	Not available.
FR	No major changes are expected compared to current levels.	Not available.

	Coverage rates	Contribution to retired people income
IE	Government policy aims at increasing overall occupational/private pensions coverage from the current level of just over 59 % of people over 30 in work to 70 % and it is hoped to achieve this through a continuation of the current voluntary regime. A review of coverage levels is required by law by September 2006. It has been indicated that if at that stage significant progress has not been made in meeting the targets it will be necessary to consider some sort of compulsory arrangement.	The replacement rate from occupational and individual pensions required to reach adequacy targets is around 16% for someone on average earnings.
IT	Coverage rates are expected to increase sharply as the diversion of TFR into pension funds applies to an increasing number of workers.	The replacement rate from supplementary pensions is projected to reach around 16 %.
CY	No major changes are expected compared to current levels.	Not available.
LV	As the mandatory participation in the second tier of the first pillar applies to new cohorts this scheme will be gradually extended to the entire working population.	The share of pensions provided by the second tier of the first pillar is projected to reach 3 % in 2030, 10 % in 2040, 30 % in 2050 and 55 % in 2060 and stabilise at 65 % afterwards.
LT	The coverage of the second tier of the first pillar may reach 60-70 % in the future.	The share of pensions provided by the second tier of the first pillar is projected to reach 40 %, with a parallel 25 % drop in benefits of the first tier of the first pillar.
LU	No major changes are expected compared to current levels.	Not available.
HU	As a consequence of mandatory membership for new entrants in the second tier of the first pillar coverage will progressively increase (68 % in 2020, 88 % in 2050).	The funded tier of the first pillar is expected to provide about one fourth of retired people's income.
MT	There are no occupational pension schemes or mandatory funded schemes in MT.	
NL	At the national level, social partners recommended in 2001 that company and sector-wide schemes should abolish the different exclusion reasons in pension schemes. The proportion of the workforce excluded from occupational pension schemes (7 % in 1996) will be halved to 3½ percent by 2006. If the social partners do not succeed in halving it the government could introduce a law abolishing the different exclusion reasons in pension provisions.	An increase from around 34 % of after tax income of retired people to around 50 % is expected.
AT	No major changes are expected compared to current levels.	The decrease in first pillar replacement rate is projected to be around 10 %, which is expected to be compensated by an increase of occupational and individual benefits.
PL	An increase in coverage is expected, as participation in the second tier of the first pillar is mandatory for all workers born after 1968 (it is voluntary for workers born between 1949 and 1968).	The share of pensions provided by the second tier of the first pillar is projected to reach 40 % and 10 to 20 % for individual schemes.
PT	No major changes are expected compared to current levels.	Not available.
SI	For occupational schemes, coverage levels are expected to increase and exceed 60 % of the workforce.	An increase is expected.
SK	An increase of coverage is expected as the new (mixed) pension system will be compulsory for all individuals who were not participating in	An increase is expected.

	Coverage rates	Contribution to retired people income
	the current PAYG pension system administered by the Social Insurance Agency.	
FI	No major changes are expected compared to current levels.	The current level of around 6-7 % of the income of retired people is expected to rise modestly.
SE	No major changes are expected compared to current levels.	Not available.
UK	Coverage is expected to increase further over time.	An increase from the current level is expected, (current level of 30 % of the income of retired people).

Source: National replies to the SPC questionnaire.

Note: It should be noted that figures presented in this table are not harmonised and may therefore not be comparable across countries.

An increase in the contribution of privately managed schemes to older people's incomes may not be neutral with regard to the future distribution of income among retired people. The overall distributional effect remains uncertain, as *a priori*, two opposing forces are at play. On the one hand, as the level of contributions generally rises with income, it is likely that the development of supplementary schemes will result in a higher dispersion of income among retired people. This will probably be the dominating effect, which may, however, be moderated by an increase in the level of coverage rates. In DK, for instance, the expansion of occupational pensions through collective agreements over the last decades has primarily benefited low and middle income earners (most people in the higher income groups, civil servants, etc had already been covered by supplementary pension schemes); this may contribute to a more even distribution of income among pensioners.

Pension assets are not the only source of wealth and income for people in their retirement. In all member states a considerable level of asset accumulation is in the form of liquid saving and housing. These assets play an important role in the income of presently retired people and will continue to play an important role in the income and wealth of future retired people.

As a conclusion of this part of the study, it can be noticed that in the future the importance of privately managed pension provision is to increase. In many Member States, the contribution of these schemes to the income of retired people is expected to rise significantly, but the public pay-as-you-go pension schemes are expected to remain the principal source of income of pensioners will in all but a few Member States (as reflected by the graph bellow).

5. THE IMPORTANCE OF PUBLIC POLICY INTERVENTION

The development of privately managed schemes represents an important transformation of pension systems with numerous implications for the role of public policies in achieving adequacy and sustainability. Governments are directly responsible for providing first pillar pensions and guaranteeing them, in the event of unfavourable economic or demographic developments, notably through the use of resources from the general budget. Privately managed pension provision, by contrast, is shaped indirectly by governments which set framework conditions, ensure the supervision of schemes and provide incentives. One important challenge will be to improve, as a precondition for good policy making, the information on private provision, both at an aggregate level and

for individuals who need to have a good understanding of private provision so as to build trust and to allow individuals to plan for their retirement.

5.1. Public support and regulation

Public policy intervention is essential in order to ensure that future levels of pensions can reach adequate levels and will be sustainable. Such intervention includes notably fiscal and other financial incentives, prescriptions on the type of benefits used or on administrative charges, regulations on prudential requirements, the legal framework for establishing schemes based on individual or collective contracts and it may go as far as making scheme membership compulsory.[29] Public policy intervention is relevant to several of the common objectives and notably the adequacy objectives n° 2 ("…enabling to maintain, to a reasonable degree, their living standards after retirement") and n° 3 ("Promote solidarity within and between generations"). Financial incentives to private pension provision are relevant to objective n° 6 (" … maintaining the sustainability of public finances") and objective 7 (" Ensure that pension provision and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter"). Public policy intervention is also required for objective 8 ("Ensure, through appropriate regulatory frameworks and through sound management, that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.") and the modernisation objectives (adaptation to flexible employment patterns, gender equality and transparency).

5.1.1. Tax incentives and level of public support

The most common tax treatment of private pension provision is EET (contributions are **E**xempt, investment income is **E**xempt, benefits are **T**axed), i.e. the taxation of income used for retirement provision is deferred until the moment benefits are paid out. This leads to some losses of tax revenues. Recent studies underline that the immediate budgetary costs in the form of foregone revenues exceed the future revenues resulting from the taxation of benefits. Revenue losses for OECD countries represent around 20 % of contributions.[30]

The costs to public budgets of incentives for private pension provision depends notably on whether contributions to such schemes are exempt from social security contributions (employers', employees' or both). For many occupational schemes there are exemptions which can be complete (ES, DE deferred compensation up to 31st December 2008, DK, IE, LU, SI, UK) or partial (as in BE, DE for occupational plans, FR, IT for the employee part, LV, PT). For individual schemes, situations among Member States vary significantly: in most cases, there are no exemptions from social contributions, but this

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[29] Information on public policy interventions is based on the replies to question 4.4 of the questionnaire (concerning the current and expected future cost to public budgets of supporting private retirement provision, notably through subsidies and exemptions from taxes and social insurance contributions). Information on prudential requirements is based on the national replies to question 4.7 (regarding provisions for the protection of members and beneficiaries against financial risk, risk of insolvency and fraud or other criminal misuse of pension scheme assets) and question 4.8 (on the main prudential requirements for assets held by private pension schemes).

[30] P. Antolin, A. de Serres and C. de la Maisonneuve (2004), "Long term budgetary implications of tax favoured plans", OECD Economic Department Working Paper n° 393.

can be the case in some Member States (e.g. CZ, HU, IE for RACs and PRSAs[31], AT for pension funds and life insurance, UK personal plans).

Moreover, employer contributions to those plans can typically be deducted as business expenses from company revenues and are not taxable as employee income either. Returns on assets managed by pension schemes are also usually exempt from taxation, although some Member States do tax yields (e.g. SE with a lower rate on yield of 15 % instead of the normal rate of 30 % and IT[32]).

Employees generally benefit from the possibility to deduct their own contributions made to privately managed plans from their taxable income while contributions paid by their employers are not regarded as income. Exemptions from income tax vary, however, from one Member State to another. They may only apply to a fraction of contributions and they are typically subject to a ceiling. These limits can be defined in absolute terms or as a percentage of incomes or as a combination of both (as in IT and SI). In some Member States, income tax exemptions are not limited: this is often the case for statutory schemes, (but not for the compulsory contributions in HU, as the system is mainly TEE), in NL for occupational and individual schemes and SE for occupational schemes. The new tax regime in the UK will introduce a lifetime tax allowance for pension savings of £1.5 million (indexed). In a few cases there is direct state support for people on low incomes who make contributions to pension schemes, but would not benefit (much) from tax exemptions. This takes the form of a direct grant (CZ individual pension, DE *Riester* pension, UK Stakeholder pension) or a tax credit.

It should also be noted that Member States can apply different tax treatments to different types of schemes. Thus in PL the second tier of the first pillar is EET whereas voluntary occupational pension plans and individual plans are TEE. Different taxation rules may also be applied depending on whether benefits are paid as annuities or lump sums. In IE and UK, part of the capital accumulated can be paid out as a tax free lump sum; in BE the tax treatment of annuities and lump sums was harmonised in 2003 in order to encourage annuity payments. Thus, tax rules and direct support for private pension provision are important policy tools for influencing the design of pension schemes, including the choice between annuities and lump-sums and the sharing of risks between schemes and beneficiaries.

About half of the Member States provided information on the total cost of public support through tax exemptions or subsidies.[33] However, it appears that the levels in these member states are far from negligible and can range from 0.5 % to 1.5 % of GDP. These are gross figures from which taxes levied on pension incomes should be deducted to obtain the net cost. Obviously, such tax revenues will grow during the build-up phase of private pension schemes and only reach their full level when these schemes have reached maturity (typically after some 40 years). Thus there will be a negative budgetary impact due to the tax exemptions and subsidies for private pension provision when such schemes

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[31] RACs: *Retirement Annual Contracts*; PRSAs: *Personal Retirement Savings Accounts*.

[32] In Italy benefits are taxed at a lower rate to reflect the fact that benefits are partly based on contributions (which had not been subject to income tax) and partly on investment returns (which had been subject to tax).

[33] CZ, BE, DK, DE, EE, IE, CY, LV, HU, NL, SE and UK provided estimations on the gross impact (i.e. excluding taxes levied on pension benefits) of tax exemptions or subsidies on the public budget.

are first established. The net costs are reduced over time as taxes are levied on the increasing amount of benefits. The distributive impact of tax exemptions should also be taken into consideration.

To the extent that private schemes are in their development phase and fill an adequacy gap created by reduced public pension levels, costs to public budgets of promoting such schemes could be regarded as a form of transition cost associated with any shift from pay-as-you-go to funded pension provision. Transition costs result from the fact that during the shift from PAYG to funded provision contribution revenue is needed to cover current pension payments and is hence not available for accumulating assets in funded schemes.

Transition costs arise in a much more direct way in those countries which are partially privatising the management of their statutory pension systems by redirecting part of the statutory insurance contributions into privately managed funds. This leaves a revenue gap in the pay-as-you-go scheme that may have to be filled by the general budget (through higher taxes or deficits), through increased contribution rates or by lowering benefits for current pensioners.

The tax treatment of private pension provision may also have implications for the free movements of workers. If they move between countries with different tax treatments (taxation of benefits vs. taxation of contributions) they may incur the risk of double taxation (on both their contributions in the country of origin and on benefits in the country of residence) or they may escape taxation altogether. Even if all countries opted for the same tax model (for instance EET, as proposed in the April 2001 Communication from the Commission on *The elimination of tax obstacles to the cross-border provision of occupational pensions* COM2001(214)) there could still be problems to the extent that the country which granted the tax exemptions on contributions may want to recoup this lost revenue when the beneficiary moves to another country, which would benefit from the taxation of benefits. The issue of double taxation (or double non-taxation) can, however, be resolved through double taxation agreements.

5.1.2. Policies to keep administrative charges low

Policy measures are also being implemented in a number of countries to keep the level of administrative charges low. This may take the form of obligations of information and transparency imposed on pension providers with the aim of inducing a downwards pressure on charges levied. Furthermore, in some Member States, this is strengthened by regular consultations of actors in order to balance the need to protect members' interests with the costs to schemes (that can be organised by the regulatory authority as in IE or mainly by social partners as in NL). The regulatory authority can also make publicly available updated comparisons of the levels of charges, including examples of calculations according to different scenarios (e.g. DK, EE, ES).

Furthermore, in some Member States, there is an obligation for companies to redirect part of their profits to members (e.g. DK, FR or HU where assets are managed by non profit institutions). Where the social partners have an important role in establishing occupational schemes they can influence the level of administrative charges and costs (e.g. DK, NL, SI or SE). Collective bargaining establishing sector-wide schemes also allows a reduction in the level of charges thanks to economies of scale. In the funded tier of the Swedish pension system an administrative fee is charged on each premium pension account to finance the Premium Pension Authority's costs (*Premiepensions–*

myndigheten, PPM). The fee is currently 0.27 % of each capital account. In addition, private fund managers levy administrative charges (which vary from fund to fund) to cover their own costs.

Some Member States have introduced direct regulations on the levels of administrative charges, for instance in the form of ceilings expressed as a percentage of contributions or of assets. In ES commissions may not be higher than 2 % of the yearly balance of an account. Moreover, management agencies receive from pension funds a maximum amount of 0.5 % of the account balance. These ceilings are to be applied to each pension scheme and to the pension fund as a whole, as well as individually to each member and beneficiary. In IE, charges are generally not controlled, although the recently introduced PRSA does feature a legislative cap on charges for the standard product. In LV, for the second tier of the first pillar, charges on contributions in pension schemes are capped at 2.5 % of contributions, but there is no limit to the fund management fee. In LT, for the voluntary second tier of the first pillar, there is a ceiling set by the law limiting maximum administration charges to 1 % of assets and 10 % of contributions while in voluntary pension funds no limits have been foreseen. In AT charges on contributions may not exceed 3.5 % in the new severance pay scheme; if rights acquired under the old severance pay scheme are transferred to an employee welfare fund, the employee welfare fund is entitled to retain a one-time cost contribution of a maximum of 1.5 % of the amount transferred and not exceeding 500€. Management charges of welfare funds may not exceed 1 % (and 0.8 % as from 1 January 2005) of the invested capital of severance pay per financial year. By contrast, no limits on charges have been introduced for traditional pension schemes and individual plans in AT. In PL, for the second tier of the first pillar, there are direct limits on the value charges and fees, which is not the case for PPE or IKE schemes. In SI, for occupational schemes, the act on pension and disability insurance determines the maximum amount of administrative charges. In SK, legislation sets a ceiling for charges in the funded second tier of the first pillar. Finally, in the UK, for stakeholder pension schemes, administrative charges must not exceed a prescribed level, commonly known as a “charge cap”, of 1.5 % of assets for the ten first years and 1 % of assets afterwards.[34] Charges on other personal pensions products have fallen by around a fifth since 1999 to around 1 % per year.

5.1.3. *Prudential framework*

The development of privately managed schemes also calls for strict prudential requirements for which there is also a framework in European legislation. Several European directives are particularly relevant in this regard: the insolvency directive of 1980, the life insurance directives and the directive on institutions for occupational retirement provision (see box).

European directives and prudential requirements

The insolvency directive (80/897EEC) guarantees the payment of outstanding claims to employees in the event of insolvency of their employer. This Directive applies to employees' claims arising from contracts of employment or work relations and existing against employers who are in a state of insolvency within the meaning of the Directive. Article 8 of this directive requires Member States to "ensure that the necessary measures are taken to protect the interests of employees and of persons having already left the employer's undertaking or business at the date of the onset of the employer's insolvency in respect of rights conferring

34 This requirement is set out in regulations and enforced by the pensions regulator (OPRA). Apart from a small number of exceptions specified in the regulations, for example concerning the costs of buying and selling investments, all other administrative charges must come within the cap.

on them immediate or prospective entitlement to old-age benefits, including survivors' benefits under supplementary company or inter-company pension schemes outside the national statutory social security schemes."

Several insurance directives cover the field of life insurance (directive 2002/83). They include the principle of a single passport allowing them to operate in all Member States. This implies notably the mutual recognition of prudential rules between Member States. The Member State in which the company has its registered office is responsible for providing the operating license and ensuring the surveillance of its financial soundness (solvency, provisions, investments). Concerning provisions, it stipulates that Member States shall make sure that sufficient technical and mathematical provisions are constituted and that their calculation is sufficiently prudent. The directives also include some rules on the diversification of investments. Moreover, some special rules are issued on solvency margins and on a guarantee fund in the event of insolvency of an insurance business.

The directive on institutions for occupational retirement provision (IORP, directive 2003/41) applies to institutions operating on a funded basis (the transposition period expires on September 23, 2005).[35] Concerning provisions, it stipulates that Member States shall ensure that institutions establish an adequate amount of funds corresponding to their financial commitments and that the calculation of provisions shall be executed and certified by an actuary, with sufficiently prudent rules (for instance for the rates of return used). Concerning investments, it includes rules on currency matching (no more than 30 % of the assets shall be invested in currencies others than those in which liabilities are expressed), on investments in sponsoring undertakings (no more than 5 %, or 10 % when the sponsoring undertaking belongs to a group), and on the allocation of assets.

In most Member States the financial protection of members is based on several tools: the presence of supervision and control authorities and a legal basis, including requirements of prudential and administrative rules of management, and rules concerning insolvency and fraud.

Member States have generally created one or several independent supervision and control agencies (they can be independent or integrated in the administration). Supervision agencies are in charge of the monitoring of the financial situation of schemes through periodical reporting including actuarial assessment of the coverage of liabilities. More specifically, they are in charge of the monitoring that schemes are adequately funded: schemes have to assess periodically the extent to which their assets effectively cover their liabilities. In the eventuality that schemes are under-funded, supervision agencies generally can ask for the introduction of a recovery plan to restore financial sustainability.

Member States generally define prudential requirements for their privately managed schemes, but the strength of these requirements varies significantly among Member States. Some Member States have chosen not to impose quantitative rules on the investment of assets, but to rely mainly on qualitative rules ("prudent person principle" as used in UK, IE, NL). However, a majority of Member States also apply certain quantitative limits or qualitative restrictions on the use of different types of investments, for instance on liquidity, debt and equity securities, issuer's country of residence, currency denomination, share of investments guaranteed by the same entity or use of derivative instruments. Moreover, Member States generally define rules of management, requiring the independence of pension funds from the sponsor or the re-insurance of pension commitments. Finally, Member States also define special rules to deal with cases of insolvency and fraud in order to protect pension rights.

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35 Institutions managing social security schemes covered by Regulation 1408/71 and 574/72, but also life insurance institutions covered by directive n° 2002/83, and companies using book reserve schemes are excluded from the scope of this directive.

However, security has some costs. In particular, tight regulations aimed at short-term financial stability can eventually become counterproductive if for instance large and rapid increases in the levels of contributions are required to restore financial reserves after a financial market downturn. This may have a pro-cyclical effect on the economy by increasing the cost of labour and reducing consumption during an economic downturn. Achieving the right balance between short-term security of pension schemes and the overall long-term robustness of the pension system remains then a challenging task for policy makers and regulators.

5.2. Information rights and management control

The development of privately managed schemes requires a good level of information so as to enable people to make the right choices, to monitor their accumulated rights and prospective pension entitlements and to assess the quality of the management of their schemes (including for instance the level of administrative charges).[36]

5.2.1. Information rights

Overall, the level of information of people on their pensions is difficult to assess, as is their ability to make the right choices ('financial literacy'). Surveys carried out in some Member States suggest that people often do not feel very well informed about their pension options. Indeed, in order to make a satisfactory choice, people need both to be well informed on their current rights and on how their choices can modify them. It should be noted that both the IORP directive (directive 2003/41, see box) and the life insurance directive (directive 2002/83) include some elements on information that has to be provided to members and beneficiaries, in particular concerning the level of their pension rights.

A first way of improving information is to provide people with regular statements on their pension rights, not only for 1st pillar schemes, but also for privately managed schemes. Indeed, individual choices have to be made on the basis of sound projections of one's future pension rights. Several Member States tend to develop tools to inform people of their combined pension entitlements. For instance, in DK companies organise meetings for members and provide access to personal information on the Internet (a common Internet database called *PensionsInfo* is operated in collaboration between a number of pension funds, life insurance companies and public authorities). In SE, the government has taken the initiative to introduce a web-based information site called *Pensionsportalen*, set to be in place during 2004. Through this pension site, the individual will receive combined information on the different possible pension sources, including public pensions (1st pillar) and occupational pensions (2nd pillar). Private individual pensions (3rd pillar) are currently not included in the forecasts but the goal is to incorporate this information as well, so as to give people a forecast of their total old-age pension. The objective of the site is to enable individuals to get a forecast of their total old-age pension. Participation in the *Pensionsportalen* is initially voluntary for private schemes and some are still unable to participate for technical reasons, but in the long term it is likely that all different pension sources will be integrated in the *Pensionsportal*. In the UK, the government is in the process of setting up an integrated Retirement Planning service to provide individuals with information and other services to

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[36] Information presented in this section relies on the national replies to the questionnaire to question 4.3, 4.10, 4.11 and 5.2.

help them plan for retirement. Two key elements will be a web-based retirement planner, which is being developed in collaboration with private pension providers and pensions tracing service. In addition, individual state pension forecasts are being sent out automatically to individuals and many employers are working with the UK government to provide their employees with a combined forecast of their state and current occupational or personal pensions.[37]

A second important point relates to information provided by pension schemes to potential members. Generally, legislation requires that members be provided with full information on a pension plan before becoming a member. For instance, in IT the private pension reform recently approved a strengthening of information and communication to members in order to increase the awareness of potential risks related notably to the expected returns and also the costs of their pension investments. In LU, when joining DC schemes or unit-linked insurance products, people have to sign that they are aware of the fact that they may lose money. AT requires, for individual pension provision, that detailed information be provided to the insurance taker on the benefits granted and the different options available. Moreover, before signing a contract for equity-linked life insurance (where the insured assumes the investment risk), insurance companies have to request the insurance taker to provide information on their experience or knowledge in the field of investments in securities and, if necessary, their financial position. A clear warning also has to be given that that no reliable conclusions can be drawn on the future development of a fund from the development of investments in the past. In the UK, before people take out an individual pension contract, they receive a detailed document from the provider which explains in clear language the main benefits, features and risks of the contract. In addition, if a customer receives advice when purchasing an individual pension contract, the adviser is required to obtain information about the customer's personal and financial circumstances to help assess the suitability of the pension for that particular customer.

Members may also receive periodically information on the situation of their schemes and of their individual rights (generally on an annual basis, every quarter in ES), including information on financial management, an overview of investments and information on administrative charges. In DK the Pension Market Council has been set up to contribute to a public debate on transparency of the investment policies of pension funds and to ensure continued focus on their investment decisions and on developments in pension scheme members' influence. In SE banks and insurance companies have to inform their customers for individual pensions products every year on the level of administrative charges in the previous year. This legislation was introduced after complaints about high administration charges. Transparency of administrative charges is expected to influence savers' choices and increase competitive pressures to keep charges low.

5.2.2. Financial literacy

Another issue is the ability of people to make suitable choices. This raises the question whether financial literacy is sufficient to make well-informed choices between the various options that are available. Some Member States have organised public information campaigns in order to increase awareness of pension issues (e.g. LT, PL) and to improve the information provided to people in order to help them make the right

[37] In 2005/6 the UK government will deliver state pension forecasts to 8 million people and aims to reach 6.3 million people with combined pension forecasts.

choices given their particular circumstances. In IE the Pensions Board has produced and widely distributed a number of simple guides on pensions as part of the National Pensions Awareness Campaign. Moreover, the process of selling pension products is closely regulated by the Irish Financial Services Regulatory Authority so as to ensure that consumers make choices which are appropriate in view of their particular circumstances.[38] In FI, the Finnish Insurance Ombudsman gives guidance and advice to customers and settles disputes between insurers and policy holders for all types of voluntary insurance. In addition the Ombudsman's office helps consumers choose their insurance cover by making comparative studies of insurance products and prices which are available on the office's web site (the site is visited every year by more than 90,000 users). The UK's Financial Service Authority similarly offers comparative tables for a range of financial products including personal pensions on its web-site. In addition the Financial Services Authority is developing a strategy for building financial capability in the UK and is working closely with the government to promote financial literacy and informed choice in pensions.

Working with the social partners is another way in which Member States can enable people to make appropriate choices about retirement provision. The UK is working closely with employers to improve employee take up of occupational pensions and to give employees who are unable to join an occupational scheme access to pension information through the workplace. In addition the recently announced Challenge Fund will support trade unions and other organisations in offering workplace pensions advice.

5.2.3. Management control and the role of the social partners and beneficiaries

Pensions typically are not provided in the same manner as other goods and services where companies offer a certain product and consumers may 'take it or leave it'. Pension 'products' are often designed by the social partners through the collective bargaining process and provided by institutions created not for earnings profits, but for serving the needs of the parties that established the pension scheme. This is also often the case for individual pension provision where non-profit organisations such as mutual benefit societies play an important role. Thus, many pension schemes are set up with the direct involvement of their members and (future) beneficiaries. Even when the initiative for establishing a pension scheme is taken by unilaterally by the employer, there may be requirements for member representatives to be part of the management board (board of trustees) of the scheme. The involvement of the social partners and member/beneficiary representatives can have an important influence issues such as the choice of the entity that will manage the fund and the choice of investment strategies; it can also contribute to improving financial literacy.

Several Member States provided information on member/beneficiary representation and involvement. In BE the participation of employees is organised through the company-level dialogue that takes place notably in work councils which provide opinions on financing, provisions, pension regulations, etc. In some cases, the administration council of the pension institution has to be composed in equal shares of delegates of employers and employees. For some group insurance contracts, a surveillance committee, with

[38] In the design of the Personal Retirement Savings Account (PRSA) a conscious effort was made to ensure that the product was straightforward and easily understood. In this regard the 'standard PRSA', which is expected to be the dominant product in this area, features a default investment strategy which minimises the decisions/choices people must make.

equal representation of employers and employees is also foreseen. In DE, depending on the type of occupational pension scheme, some institutions' boards of directors have equal representation of employers and employees. In ES, the management of occupational pension schemes is supervised by a surveillance committee made up by representatives of all interested parties (sponsor(s), members and beneficiaries), which oversees the scheme rules which define the rights of members and beneficiaries, puts forward and agrees changes in contributions and benefits (and other variables or aspects of the pension scheme), supervises the financial situation of the scheme and ensures the legal representation of the collective interests of members and beneficiaries regarding the pension scheme. In FR, the mutual benefit societies (*mutuelles*) and the welfare institutions (*institutions de prévoyance*) are partnerships comprising employees, employers and beneficiaries who jointly control these institutions which can cover a company, a profession or a sector of activity. In the provident funds of CY, the management committee is composed of representatives of employers and employees on a roughly equal basis.. In AT, the pension provider under the new severance pay scheme is selected on the basis of an agreement between the employer and the works council. If one third or more of the employees reject the initial choice, a second proposal must be made and if that still does not receive the approval, an arbitration board has to decide. Trade unions appoint two employee representatives to the supervisory board of the selected pension provider. In PL, member have no direct control in the case of the OFE (pension funds under the statutory scheme), while for voluntary PPEs company agreements exist which determine also the role of the financial institution running the scheme; on this basis, the employer negotiates the agreement with the plan provider. The collective pension schemes for public employees of SI are overseen by a board of members established with equal representation of the government and of members of the pension scheme. In the occupational pension schemes of FI at least two employees have to be nominated to the administrative board of a company pension fund and at least three employees to the administrative board of an industry-wide pension fund; nevertheless, the employers have the main role in the scheme design.

In NL the representation of beneficiaries (pensioners) is particularly developed. In 2003 the Labour Foundation (*Stichting van de Arbeid*) and CSO, the organisation representing elderly people reached an agreement to improve the participation of pensioners by means of establishing beneficiaries' councils or by including one or more representatives of pensioners in the supervisory board of pension funds. The application of this agreement is to be evaluated in a survey to be carried out in July 2005.

5.3. Monitoring

The increasing importance of privately managed schemes also calls for the development of better monitoring tools so that information on the development of such schemes is available. It is essential to dispose of a general overview of pension schemes for the decision making process of policy makers. In that respect, it should be noted that improvements are required not only at the national level in most Member States, but also in the production of comparable international data.

Instruments of data gathering are particularly important as they enable the monitoring of the evolution of private pension provisions. It should be stressed that in a number of

Member States official statistical information on key variables such as coverage rates, levels of assets, or rates of returns is very limited.[39]

In most cases monitoring is achieved through direct reporting to supervision authorities to which pension schemes have to provide periodical reports.[40] However, it should be noted that from a social protection perspectives this way of collecting data can have some serious weaknesses; it is very difficult to avoid double counting (people being members/beneficiaries of several schemes at the same time) and information is sometimes highly aggregated. In some Member States, the monitoring capacity of the supervision authority is to be reinforced in the coming years, leading to improved information collection (e.g. LU) or more up-to-date information (e.g. NL on the number of active and non active members, on pensioner's participation in the board of a pension fund, on indexation or on investments).

Monitoring of privately managed pension schemes may also be achieved through specific representative surveys (like the Household Survey in IE, or the Family Resource Survey in the UK; in BE feasibility studies are currently being conducted and various data bases, including administrative data, are being analysed; this could yield better information particularly on coverage levels). Information can also be collected through income tax declarations, as contributions to individual schemes can often be deducted from taxable income (this will be the case as from 2005 in IE).

Finally, improvements are being introduced in the context of international data collection programmes (EUROSTAT and OECD) in order to allow for a more detailed analysis of privately managed pension schemes. Data to be produced include for instance coverage levels, contributions, levels and structure of investments, rates of return and of administrative charges. A shortcoming of such data has been that it focuses too much on particular types of institutions rather than the overall role of privately managed pension systems in social protection systems.

6. CONCLUSIONS

The present report confirms the trend towards an increased role of private pension provision in the pension systems of EU Member States, many of which consider that the future adequacy and sustainability of their pension systems is built on a combination of public and private pillars. However, in all but a few Member States, the public pay-as-you-go pension schemes are expected to remain the principal source of income of pensioners. This will allow Member States to maintain a degree of redistribution and solidarity that is necessary to provide adequate incomes to all older people and to mitigate risks associated with private provision.

The increased role of privately managed pension provision do not diminish the overall responsibility of governments for adequate and financially sustainable pensions. Governments shape privately managed pension provision by setting the right framework conditions, by putting in place regulatory and supervision authorities and by cooperating with other key players, in particular the social partners and the financial services sector. The report has demonstrated that privately managed pension provision is extremely

[39] Information on process of data collection and monitoring capacity was asked in question 4.6.

[40] E.g. BE, CZ, DE, ES, FR, IT, LT, LV, LU, NL, AT, PL, PT, FI, SK, SE and UK.

diverse across the EU. The role privately managed pension provision plays in each Member State and the way in which it is managed varies greatly. The open method of coordination and the process of preparing national strategy reports presenting pension systems and policies provide an opportunity to understand the role of privately managed pension schemes and to facilitate mutual learning.

Such mutual learning, however, is made difficult by the fact that statistical information available for analysing the current and future role of privately managed pension provision is, in many countries and at EU-level, not optimal. Significant improvements should be made to facilitate better policy making. Various ongoing projects at EUROSTAT and the OECD should yield better information over the coming years. In addition, information on the regulatory environment in which private pension provision operates could be collected through MISSOC and with the help of the Pensions Forum.

The preparation of national strategy reports on pension systems and policies should also be seen as an opportunity to assess the role of privately managed pension schemes in the overall pension system design and to examine whether current policies are appropriate. This report has highlighted a number of key issues; some of them are also referred to in the recently adopted 'Guidance Note' by the SPC and the Economic Policy Committee for the next round of national strategy reports. The SPC hopes that the issues identified in this report will inform the drafting of national strategy reports and national policy debates on the role of privately managed pension provision in the overall pension system.

(1) How much privately managed pension provision will be necessary to achieve adequate pensions?

The role of private pension provision is closely linked to the current and prospective level and design of public/pay-as-you-go provision, but also the accepted role of the State in each Member State. Moreover, depending on their personal circumstances and in particular the income level (replacement rates in public schemes tend to be higher for low-income workers), individuals have to rely to varying degrees on private provision to achieve adequate incomes in old age.

(2) Is the development of privately managed pension provision on track for meeting future needs?

A low level of public/pay-as-you-go pension provision will not automatically be compensated for by a sufficiently high level of private provision, exposing some groups to an increased risk of inadequate incomes in old age. Whether the actual development of private pension provision matches the need for it can be assessed by looking at the level of coverage, the average level of benefits and their distribution and the level of contributions to privately managed schemes. Trends in these variables will determine the future role of private pension provision. The situation needs to be reviewed for different groups (e.g. by income, gender etc.).

(3) Is there enough room for solidarity and redistribution?

It is important to consider whether the mix of public and private provision guarantees sufficient insurance against biometric risks (e.g. lump sum payments would reduce the protection against the longevity risk), short-term fluctuations on financial markets and periods of labour market inactivity risk of not being able to make sufficient contributions to pension schemes (notably due to unemployment, invalidity, care responsibilities). Furthermore, it may be useful to examine the impact of the development of private pension provision on pay-as-you-go systems

and their capacity to provide adequate pensions to the population as a whole, taking into account the revenue losses (through tax exemptions and the redirecting of social insurance contributions into private funds) and the cost of public subsidies.

(4) Are private schemes sufficiently transparent and are individuals able to make the right choices (financial literacy)?

Private retirement provision requires the use of sophisticated financial services. Choices made by individuals have consequences over very long periods of time and determine the level of retirement income. If individuals have to take more such decisions themselves, their understanding of financial services must be sufficiently developed ('financial literacy') and accurate information must be available. Alternatively, decisions about private pension provision can be taken collectively through the collective bargaining process or by making certain forms of provision mandatory.

(5) Do privately managed schemes operate at a sufficiently high level of security and efficiency?

Pension scheme assets have to be managed safely and in the best interests of members, but this should not be at the expense of efficiency. Rules on acceptable investment risks (which may differ from one scheme to another) and prudent assumptions about future returns are important safeguards if there application is well enforced and monitored. Another possible way of enhancing the safety of pension schemes is to promote management structures in which members and beneficiaries are involved, allowing them to exercise control over the right balance between safety and efficiency. Efficiency also means ensuring that administrative charges can be kept low. Ways of achieving this is include opting for collective rather than individual provision and setting charge caps.

(6) Are public policies geared towards achieving the best outcomes from private pension provision?

Public policy shapes private pension provision. Governments thus have a role, in various ways, in all three pillars. The levers available to policy makers include making membership mandatory through direct legislation or the recognition of collective agreements; giving financial support to private provision through tax concessions or direct grants (often linked to conditions which will influence the scheme design); establishing prudential rules and supervision structures; defining the rights of members and beneficiaries to information and to control the management of their schemes; promoting awareness of pension issues and a better understanding of financial services.