Pension reform and coverage

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Summary

The ageing of the population and the likely consequences of this for sustainability of public pension systems are major concerns for the countries of the EU. Almost all social security schemes are financed on a pay-as-you-go basis and are susceptible to changes in the old-age dependency ratio. The prognosis is particularly alarming for Italy, Spain and Germany, where the ratio is projected to rise to about 60%, from current levels of around 30%. A feature of most of these social security systems is a fixed pension age. This needs to go up by 6 to 11 years between 2010 and 2050 if the ratio of those over pension age to those at working ages is to remain at current levels.

The financing of funded private pension plans is not directly affected by the worsening old-age dependency ratio, but increasing expectation of life at retirement age is a serious concern for the cost of complementary pensions. In order to maintain the expectation of life at retirement age at current levels, effective retirement age will need to go up by 5 or 6 years over the next 40 years.

There is very limited scope is available to the EU to coordinate policy, either for the first pillar, or for second and third pillar complementary pensions, since pensions and social security does not fall within the powers of the EU treaties. However, much discussion has taken place and a number of major reports have been published, both by the European Commission and the European Parliament, with exhortation to member states to take steps to address the unsustainability of many current systems.

The most significant EU legislation on funded pension plans is Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (the so-called IORP Directive). This covers many aspects of good governance and supervision of pension plans but still leaves a lot of discretion to member states. In April 2011 the European Commission asked the European Insurance and Occupational Pensions Authority (EIOPA) for advice on an EU-wide legislative framework for IORPs, raising the question as to whether something similar to the Solvency II framework for insurance regulation could be developed. EIOPA delivered their advice in February 2012. It is expected that the European Commission will propose a new draft Directive on IORPs at the end of 2012, but the ideas covered in the Call for Advice are quite controversial and it is likely that it will take several years for a new Directive to be negotiated. One key objective is to achieve an increase in cross-border pension provision, but this is still inhibited by tax regimes.

The 2011 European Parliament report recommended raising retirement age, increasing participation in the labour market at older ages and a good mix of funded and pay-as-you-go pension arrangements. Some countries are working on increasing retirement age. Others have created incentives for people to work longer, rather than changing the formal required age of retirement.

Many different reform measures have been enacted in different countries, including Notional Defined Contribution in Sweden, the sustainability index in Germany, introduction of funded pension plans in Germany and France and conversion to pension using the latest estimate of life expectancy in Finland. In the UK a new requirement for employers to auto-enrolment employees in a pension plan is being introduced later in 2012.

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