



High-level group of experts on pensions

**FINAL REPORT
OF THE HIGH-LEVEL GROUP OF
EXPERTS ON PENSIONS**

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Acknowledgments and legal notice

This independent report was prepared by the High-level group of experts on pensions¹ to provide analysis and policy advice relating to the role of supplementary pensions in contributing to adequacy of old age incomes and the development of their market in the EU.

This report reflects the views only of the authors, and the European Commission cannot be held responsible for any use which may be made of the information contained therein.

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¹ The Group was set up in accordance with European Commission Decision (C)2017/8523 setting up a High-level group of experts on pensions

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Key recommendations

With a view to ensuring adequate retirement incomes, the EU and Member States should conduct further in-depth analysis to identify existing gaps in old-age protection systems, e.g. along gender lines, professional groups or age cohorts.

When reforming their pension systems, Member States should create or retain a pension-friendly legal environment (social, labour and tax law) and appropriate prudential framework. Member States should take a long-term and holistic approach to developing multi-tier pension systems, based on strong public pensions and acknowledging the specific roles of different types of schemes. Occupational pension schemes are characterised by a social purpose and, depending on the national strategy, can play a central role in old-age income replacement. Both Member States and the EU should actively support, strengthen and promote social dialogue and collective bargaining to foster the development of occupational pensions with broad coverage. Personal pension schemes, as voluntary individual products, are a useful component of a diversified and balanced pension system in some countries and can play an important role in supplementing retirement income.

Due to the widely varying architecture of the Member States' pension systems, different financial capacities (of the state, the employers and the individuals) and the interdependencies between statutory, occupational and personal pensions, there are no one-size-fits-all solutions.

The Group, in particular, recommends that:

- Member States should provide financial and regulatory incentives encouraging social partners to set up collective pension plans that ensure risk-sharing between members, while respecting the autonomous competences of the social partners and the sponsoring companies.
- Member States and occupational pension providers should ensure that occupational pensions provide pension credits for career breaks linked to child care or other caring responsibilities, protecting the accrual of pension rights and encouraging equal sharing of care responsibilities between women and men. Such credits may be financed from various sources.
- Member States should reserve tax and/or financial incentives in both the saving and the pay-out phase for supplementary pensions meeting minimum quality requirements. These incentives should reflect the diversity in characteristics of types of pensions and the related social policy of a Member State.
- The EU, the Member States and the social partners should develop cost-effective tools and methodologies to assess the vulnerability of European pension providers in the EU to long-term environmental and social sustainability risks.
- The EU should establish a regular multi-stakeholder forum of structured exchange between social partners, pension providers, beneficiary representatives, independent experts and EU authorities on pensions.

Introduction

1. Aim of the report

Principle 15 of the European Pillar of Social Rights states that “*Workers and self-employed have the right to a pension commensurate to their contribution and ensuring adequate income. Everyone in old age has the right to resources that ensure living in dignity*”.

By Commission Decision C(2017) 8523 a High Level Group of Experts on Pensions was set up “to prepare an independent report providing analysis and policy advice relating to the role of supplementary pensions in contributing to adequacy of old age incomes and the development of their market in the Union”.

Reflecting the diversity of backgrounds and experiences of the group members, this report seeks to provide both an analysis of the most pressing challenges and related developments as well as policy recommendations aiming to improve the contribution of supplementary pensions to adequate retirement incomes.

The group agreed to build its report on the 2018 Pension Adequacy Report³ (PAR) which explores in detail the opportunities for people in different types of employment and self-employment to acquire adequate pension rights and dwells on how supplementary savings, in particular occupational pensions, contribute to old age incomes in different Member States. The report’s key conclusions, endorsed by the EU Council, called for further in-depth consideration of the potential contribution of supplementary schemes to adequacy.

Following the definitions used in the PAR, supplementary pensions are pension schemes that can be accessed on the basis of professional activity (occupational pensions) or individual pension saving contracts (personal pensions) and provide additional retirement savings, supplementing statutory pensions⁴. Throughout the report the group makes a clear differentiation whenever relevant between occupational and personal pensions.

In chapter 1, key issues are examined, such as conditions affecting coverage, the level of retirement savings and the pay-out phase, considering how it affects the observed trend of shifting of risk towards individuals. In chapter 2, challenges specific to the EU dimension of supplementary pensions, including the development of the EU market for occupational and personal pensions, are addressed. Chapter 3 deals with the potential contribution of supplementary pensions to the EU’s sustainable investment agenda.

³ European Commission and the Social Protection Committee, *Pension Adequacy Report 2018*, Publications Office of the EU, <https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8084&furtherPubs=yes> -

⁴ Statutory funded pensions, i.e. pension schemes established by legislation and financed by converting part of social security contributions into funded assets, are not considered supplementary pensions for the purposes of this report, as they partially replace rather than supplement retirement income from public pensions. They are referenced in the report when discussing the policy context in Central and Eastern European countries in particular.

To illustrate its analysis, the report presents some examples of good and poor practices in the field of occupational and personal pensions.

Finally, based on the analysis of challenges and policy responses, the report puts forward a number of recommendations addressed to Member States, the EU and other actors.

2. Background

Pensions aim to protect retired people from old age poverty and the risk of outliving their resources, smoothen consumption and allow them to enjoy decent living standards. They are the main source of income for about a quarter of the EU population. In most EU countries, pension income primarily comes from public pensions, while in some Member States occupational schemes provide up to half of pension income⁵. In 2018, on average pensions in the early years after retirement amounted to 58% of late career work income with significant differences both within and between EU Member States, ranging from 35% in Ireland to 87% in Luxembourg⁶, and the value of pensions erodes as pensioners get older⁷. Medium to high supplementary pension coverage is mostly found in countries characterised by an active role of social partners and collective bargaining and by developed financial markets.

In most Member States multiple pension gaps both in access and in benefit accrual can be observed. This is in particular the case for workers involved in new forms of employment. The increasing number of jobs which do not provide access to any pensions lowers the overall capacity to save for old age. Promoting quality employment and expanding pension coverage are thus crucial to boost workers' capability of accruing decent pension entitlements, both in public and supplementary schemes. Also, women tend to have significantly lower pensions than men. This means that while almost one fifth of the people in the EU aged 65+ are at risk of poverty or social exclusion, this figure is much higher for women.

In the context of an ageing population, increasing life expectancy, expanding non-standard forms of employment, high at-risk-of-poverty rates, a modest 58.7% employment rate of people aged 55-64⁸, persisting low interest rates and volatile financial markets, effective pension and labour market policies are needed to cope with population ageing in a fair and sustainable way, also having regard to the diverse nature of pension providers and market developments in Europe.

Pension policies are mostly in the national competence of Member States. The EU legal framework covers some aspects related to pensions, such as protection of rights in case of cross-border mobility, consumer protection, gender equality and the single market for supplementary pensions. Beyond this, the EU supports Member States' efforts to ensure adequate and

⁵ The Netherlands, Denmark. In Finland, the main source of pension income is the quasi-occupational part of the statutory pension system.

⁶ Ratio of the median individual gross pensions of 65-74 age category relative to median individual gross earnings of 50-59 age category ('aggregate replacement ratio'). Eurostat (provisional value for IE).

⁷ 2018 Pension Adequacy report.

⁸ Eurostat; 2018 value.

sustainable pensions through the European Semester, the European Pillar of Social Rights and the Open Method of Coordination (OMC) of mutual learning and exchange of best practices.

The OMC on pensions, launched in the early 2000s, defined a common set of objectives to ensure adequacy, financial sustainability and modernisation of pension systems, including adequate and financially sound provision of occupational and personal pensions⁹. The 2012 White Paper on pensions highlighted the challenge of maintaining adequate, safe and sustainable pensions in an ageing society and reiterated that developing supplementary savings can contribute to the solution¹⁰. Every three years, the Commission and Member States jointly prepare the Pension Adequacy Report and the Ageing Report, analysing the current and future pension adequacy and the sustainability of ageing-related expenditure respectively.

Over the last decade, pension reforms in EU Member States have on average primarily focused on containing public spending. As a result, despite massive population ageing, public pension expenditure as a share of GDP is now expected to be even slightly lower by 2070 than today in the EU on average, mostly due to a strong decline in future public pension replacement rates, with large variation across Member States¹¹.

In recent years, measures aimed at raising the level of low public pensions (in particular for low-income earners), have become more prominent¹².

In some Central and Eastern European countries, statutory funded schemes based on diverting contribution from public pay-as-you-go to privately managed funded DC schemes were rolled back¹³.

The 2019 Council Recommendation on access to social protection recommended that all workers, regardless of the type of employment relationship, and the self-employed should be effectively covered by social protection schemes. The Recommendation stresses that, when assessing adequacy, the Member State's social protection system needs to be taken into account as a whole.

The 2019 Annual Growth Survey¹⁴ again highlighted the challenges posed by Europe's ageing population for the sustainability and adequacy of pension systems and called for reforms aimed

⁹ Joint report by the Commission and the Council on adequate and sustainable pensions (Council (EPSCO / ECOFIN) 7165/03), endorsed by the European Council on 20-21 March 2003 (Council 8410/03)

¹⁰ European Commission, White Paper: An Agenda for Adequate, Safe and Sustainable Pensions, 2012, <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0055:FIN:EN:PDF>

¹¹ 11.4% of GDP in 2070 against 11.9% in 2016 (in between, the GDP ratio is projected to reach 12.7% by 2040. European Commission, The 2018 Ageing Report: Economic and Budgetary Projections for the EU Member States (2016-2070); https://ec.europa.eu/info/publications/economy-finance/2018-ageing-report-economic-and-budgetary-projections-eu-member-states-2016-2070_en

¹² 2018 Pension Adequacy Report

¹³ ILO, [Reversing Pension Privatizations. Rebuilding public pension systems in Eastern Europe and Latin America](https://www.ilo.org/secsoc/information-resources/publications-and-tools/books-and-reports/WCMS_648574/lang-en/index.htm) (2018), https://www.ilo.org/secsoc/information-resources/publications-and-tools/books-and-reports/WCMS_648574/lang-en/index.htm

¹⁴ 2019 European Semester Annual Growth Survey, https://ec.europa.eu/info/publications/2019-european-semester-annual-growth-survey_en

at adapting the balance between working life and retirement and supporting complementary retirement savings.

In President von der Leyen's political guidelines for the European Commission 2019-2024¹⁵, it is announced that the Commission will prepare an action plan for the implementation of the European Pillar of Social Rights. The Commission has also undertaken to prepare a report on ageing, followed by a Green Paper on Ageing, which should launch a wide debate on long-term impacts of ageing, notably on care and pensions, including an assessment of the fitness of European social protection systems to deal with the needs of an ageing population.

A holistic approach to pension policies, considering both the interplay between labour markets and pensions and between state pensions and supplementary sources, quite different in each Member State, is necessary. Only this can help to understand the behavioural responses to pension policy. Adequacy can only be evaluated considering the whole impact of pension policy on inter- and intra-generational income distribution, which, in turns, informs about the extent to which pension reforms are shifting risks towards individuals.

3. The role of supplementary (occupational and personal) pensions

Since the 1990s, the role of supplementary pensions, in particular occupational pension plans has increased in the EU, both within pension systems that are historically more universal and within social insurance systems. However, in countries where the income maintenance goal is integrated in the public pay-as-you-go pension system, the role played by supplementary pensions is generally still more limited than in countries where public pensions only provide basic income protection.

Besides its role in providing adequate retirement income, the development of supplementary pensions can also play an important part in fulfilling the EU's sustainable finance goals¹⁶. Efforts to improve pension coverage, in particular through higher participation in supplementary pensions EU-wide, would stimulate long-term and sustainable investment. As asset owners, EU supplementary pension providers could also contribute to the EU's sustainable finance goals through their stewardship of investee companies and impact of the latter on environment, social and governance (ESG) factors.

While a general trend towards an increasing role for supplementary pensions can be observed, their development in the EU displays clear regional patterns with coverage remaining low to non-existent in the South and the East of the EU¹⁷. Any effort to improve pension adequacy should thus consider the wide variety of retirement pension instruments currently available and

¹⁵ Ursula von der Leyen, A Union that Strives for More, My Agenda for Europe, Political Guidelines for the Next European Commission 2019-2024, https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_en.pdf

¹⁶ Supplementary pensions can also be seen as contributing to the goals of the Capital Markets Union (CMU). The CMU is analysed by the High-level forum on CMU set up by the Commission, which started its work in November 2019.

¹⁷ 2018 Pension Adequacy Report

the evolution of labour market participation (increasing part-time and non-standard workers) to design pension systems that will meet the needs of today and future pensioners and guarantee that *everyone in old age has and will have the right to resources that ensure living in dignity*, as enshrined in Principle 15 of the European Pillar of Social Rights.

Challenges related to the concept and design of supplementary pensions and their contribution to adequate and sustainable retirement incomes

1.1. Factors affecting the coverage of supplementary pensions

1.1.1. Coverage today

When assessing the need for supplementary pension saving, and whether the present coverage matches that need, one has to take into consideration the overall design of the pension system. Supplementary pensions provide additional retirement savings, complementing statutory pensions and thus enhancing the income maintenance capacity of pension systems. Their relative importance varies significantly depending on their role vis-à-vis statutory pensions. People's expectations from the different pension pillars and attitudes towards retirement planning are shaped by behavioural, cultural and historical factors, such as the importance of intergenerational solidarity principle. In some societies, the state is expected to take care of old-age income provision; in others, the weight of expectations is on the social partners; while in some, people are relatively more inclined to take personal responsibility when preparing for their retirement.

Since the 1990s, the role of supplementary pensions, starting with occupational pension plans, has, with a few exceptions increased in Europe, but with major regional differences. Overall, the coverage remains insignificant in about half of Member States. (See Table I in Annex for details.) Given the long accrual period, supplementary pension schemes take decades to mature and to be able to produce contribution to retirement incomes¹⁸.

The highest coverage of **occupational pensions** can be observed in Northern European countries¹⁹, where occupational plans fulfil the key income replacement function in old-age and are mandatory (based on legislation) or quasi-mandatory (based on collective agreements). Occupational pensions were also designed to play a central role in the Irish and United Kingdom (UK) pension systems by topping up flat-rate public pensions, however, their coverage has been eroded in recent decades; current policies aim to rebuild it. In Western European Member States with an earnings-related public pillar, occupational pensions play a more complementary role, yet in some (Belgium, Germany) have achieved coverage of over 50% of the labour force. Based on increasing coverage of collective bargaining agreements Belgium expects the coverage to rise to include nearly all of active workforce.

¹⁸ 2018 Pension Adequacy Report, Vol. I, p. 79

¹⁹ The Netherlands, Sweden and Denmark. In Finland, the occupational component is embedded in the public pillar, where the earnings-related pensions are organised in a quasi-occupational manner, with a strong role of social partners.

Southern European Member States are mostly characterised by strong reliance on public pensions, with relatively little role for occupational pension saving (with the exception of Cyprus). In the Central and Eastern European Member States (except Slovenia), the role of occupational pensions has been marginal or non-existent. Since the 1990s, several countries have opted to diversify the financing methods of their pension systems by developing statutory funded pensions, in some cases dismantling or downsizing them later²⁰.

Automatic enrolment: the United Kingdom example

To increase coverage, some Member States have introduced mandatory automatic enrolment in occupational pension schemes, with an opt-out option. For example, in the UK the introduction of auto-enrolment in 2012, has led to an increase in occupational pensions coverage and is expected to reduce the gender gap in pensions. Thus, since 2012, more than 10 million people have been enrolled and opt-out rates have remained low. To mitigate the risk of high opt-outs, contributions were set at a low level and phased-in. They started with a minimum 3% of total earnings (1 % by the employer and 2% by the employee), were increased to 5 % (2% - employer and 3 % - employee) in 2018, and reached 8 %, (3 % - employer and 5 % - employee) in April 2019. In addition, the UK government provides tax relief, available under certain conditions. However, certain groups, like the low-income earners, were not covered by the auto-enrolment initiative.

Since 2017 a regulatory review is being carried out to assess the impact of the reform and to investigate ways to further increase coverage, for example by including self-employed, low income earners and younger workers.

Other Member States have introduced or are considering introducing automatic enrolment (**Poland, Ireland, Lithuania**)²¹.

The coverage of **personal pensions** also varies across countries. In all but a few European countries, personal pension products tend to serve a “top-up” function, aiming to complement incomes stemming from statutory (and sometimes occupational) pensions. According to EIOPA data from 2014²², personal pensions attracted 67 million savers in Europe (27% of EU population aged 25-59) and amounted to €1,089 bn of assets under management; however, these savers and assets are concentrated in a few countries. Personal pensions can be hard to delineate from other savings products, so data on coverage and savings should be treated with caution due to lack of comprehensive and comparable data.

²⁰ E.g., Hungary, Poland. In 2018, Poland adopted a new reform aiming to roll out occupational pensions.

²¹ For more information and country examples beyond the EU please refer to: https://www.oecd-ilibrary.org/finance-and-investment/oecd-pensions-outlook-2014/increasing-private-pension-coverage-and-automatic-enrolment-schemes-evidence-from-six-oecd-countries_pens_outlook-2014-7-en

²² PEPP impact assessment, p. 11, referring to EIOPA technical advice, 2014, EIOPA BoS Preliminary Report to the Commission

Personal pensions as voluntary savings products are greatly influenced by the tax treatment and other financial incentives, which is factored in by savers when deciding to save in personal pensions instead of other, more short-term savings vehicle. Different approaches to designing financial incentives have a different impact on the take-up and savings levels²³. Fiscal incentives together with direct subsidies aimed at making personal pension savings attractive also to middle and lower-income groups resulted in the highest increases of coverage rates in the Czech Republic and Germany (though with rather limited savings amounts).

1.1.2. The coverage of different population groups

Form of work

Workers in non-standard and self-employment are less likely to be covered by supplementary pension schemes. Together with less favourable access and accrual conditions in public schemes, this can further erode their old-age income adequacy.

Social protection, including pensions, has traditionally been geared primarily to workers in full-time, open-ended contracts, however the world of work is rapidly evolving beyond these traditional jobs. The Recommendation on access to social protection²⁴ notes that, a variety of employment relationships and forms of self-employment exist in Union labour markets alongside full-time open-ended employment contracts. Some of them have already been known in the labour market for a long time (such as fixed, temporary, part-time, domestic work, or traineeships); others developed more recently and increased in importance since the 2000s (on-demand work, voucher-based work, platform work, etc.) Digitalisation is speeding up changes, and the future of work is likely to increasingly feature new forms of self-employment or employment such as platform work. However, evidence shows that some non-standard workers and some self-employed have insufficient access to the branches of social protection which are more closely related to the participation in the labour market.

The OECD observes that full-time employees are more likely to be enrolled in voluntary funded pensions than part-time workers and the self-employed²⁵. Similarly, the 2018 Pension Adequacy Report notes that the self-employed typically have much more limited access to occupational pensions than employees, either because they are excluded from this type of saving in view of their status, or because the access is voluntary and the take-up is low. Access of non-standard workers to occupational pensions, in particular for categories such as temporary agency workers, may be hampered even in countries with quasi-universal coverage, because they are less likely to be covered by collective labour agreements or may be subject to special conditions²⁶.

²³ OECD(2018), *Financial Incentives and Retirement Savings*, OECD publishing, Paris, <https://doi.org/10.1787/9789264306929-en>, p. 176

²⁴ Proposal for a Council Recommendation on access to social protection for workers and the self-employed, Political agreement, SOC 775 EMPL 583, <http://data.consilium.europa.eu/doc/document/ST-15394-2018-INIT/en/pdf>. Private insurance is outside the scope of the Recommendation.

²⁵ Antolin, P. (2008), "Coverage of Funded Pension Plans", OECD Working Papers on Insurance and Private Pensions, No. 19, OECD publishing, © OECD, <http://dx.doi.org/10.1787/241142156207>

²⁶ 2018 Pension Adequacy Report

Independent and self-employed: the Belgian example

To address the low participation of independent and self-employed workers in supplementary pensions in **Belgium**, the self-employed have access to second pillar pension arrangements, the so called PLCI (“Pension Libre Complémentaire pour Indépendants”) and are given the opportunity to complement their statutory first pillar pension income with socially and fiscally incentivized supplementary pension schemes. As of today, more than 50% of self-employed are contributing in “PLCI” schemes.

Furthermore, to increase coverage and levels of private pension savings among self-employed, who did not set-up their own company (physical persons), a recent reform adopted in 2018 has harmonized criteria for tax eligibility between all categories of self-employed (regular and executives) and has introduced a new arrangement called CPTI (“Convention de Pension pour Travailleurs Indépendants”).

Saving in personal pensions depends on the individual’s financial capacity and willingness, which can be a challenge for non-standard workers in particular, but it can offer an alternative for some groups with limited or no access to occupational pensions. Thus, in the Netherlands, about 75% of the self-employed without employees are covered by personal pensions.

Gender

Women tend to have less access to supplementary pensions than men, which can exacerbate the gender gap in pensions. According to SHARE²⁷ data, in countries with a mature occupational pillar the gender gap in the coverage of current elderly population varies from 6 p.p. in Sweden to 34 p.p. in the Netherlands. Coverage is growing more rapidly for women, leading to gradual decrease in gender coverage gaps, but they remain large. Personal pension take-up also tends to be lower for women²⁸.

There are huge gender differences in coverage per sector: highly feminine labour sectors tend to offer less opportunities to workers to contribute to occupational pensions. Furthermore, women are engaged in non-standard forms of employment (see above) more often than men for various reasons linked to gender-based disadvantage that accumulates over the life-course.

²⁷ Survey of Health, Ageing and Retirement in Europe

²⁸ Bettio, F. et al (2018), *Future Risks for Gender Inequality in Old Age Income Security*, report prepared for the European Commission (unpublished)

Gender equality - the International, Nordic and Belgian examples

In June 2019, the G20 endorsed the GPFI-OECD G20 **Fukuoka Policy Priorities to better deal with Aging and Financial Inclusion**²⁹. The Policy priorities call for more attention to be paid to the greater challenges faced by many older women who live longer and are at higher risk of poverty in old age than men.

At national level, the Nordic countries have introduced reforms to social protection systems mitigating inequalities, which women are still experiencing on the labour market. Indeed, generally lower incomes and shorter careers are one of the major reasons for women's lower pensions. This is often due to maternity and other childcare leave, which affect women more than men.

To reduce the gender pension gap in **Sweden**, in the occupational ITP³⁰ pension plans contributions are paid by the pension provider during parental leave or time off for child care for a maximum of 13 months. The contributions are calculated based on the average of the last 12 months income before the month prior to parental leave. In 2017, to further monitor gender differences in pension entitlements, an Action plan for gender-equal pensions including occupational pensions was adopted by a cross-party parliamentary Working Group on Pensions. Currently, the group is responsible for monitoring why women have shorter careers, what the pension entitlements for parental leave are and how this contributes to gender (in)equality in pensions. The group also investigates the impact of factors unrelated to the national pension system, such as the development of part-time work, the social security system for parents, the inequalities at the labour market, and the differences in occupational pension schemes coverage.

In **Denmark** during maternity, paternity and parental leave contributions are no longer paid to the private occupational pensions but are replaced by a doubling of the contributions made to the ATP (a statutory, fully funded, collective insurance based, defined contribution (DC) scheme) covering all workers. These contributions are paid for 1/3 by the beneficiary and 2/3 by the government/municipality of their residence. The government expense is covered by contributions paid to the scheme by private employers³¹. This helps mitigate the impact of career breaks due to childcare on pension entitlements.

To improve pension adequacy in the long-term and support a better understanding among policy

²⁹ G20 Fukuoka policy priorities on Aging and Financial Inclusion, 2019, <https://www.oecd.org/g20/summits/osaka/G20-Fukuoka-Policy-Priorities-on-Aging.pdf>. The policy priorities aim at reducing pressure on public pensions, increasing formal savings and avoiding old age poverty.

³⁰ The ITP agreement is the agreement between the Confederation of Swedish Enterprise and the Council for Negotiation and Co-operation for Salaried Employees (PTK) governing the occupational pensions for salaried employees in the private sector.

³¹ <https://www.oecd.org/els/public-pensions/PAG2017-country-profile-Denmark.pdf>

makers of the consequences of pension reforms on specific sub-groups, the **Belgian Bureau du Plan**³² has introduced microsimulation models for shorter/part-time and interrupted careers (groups which include a high number of women). In their 2018 study on pension adequacy, they compare projections on the impact of pension reforms in 3 EU countries (Belgium, Italy and Sweden).

Gender equality examples from the private sector

In the private sector, gender equality is sometimes promoted in specific occupational pension plans on the basis of contractual obligations, with no state involvement. In **Belgium** and **France**, for example, some major companies have introduced mechanisms to mutualise parental leave within their occupational pension schemes, a form of redistribution covering some non-contributory periods. Within these companies' (old) defined benefit (DB) schemes there is a so-called "solidarity fund" funded by an annual percentage of the rates of return, rather than by the employers or employees. The solidarity fund pays out the premiums during employees' parental leave.

Income level

People with lower incomes tend to have less access to supplementary pensions, while income inequality in the EU is on the rise, reflecting the growing polarisation in the labour market. Pensions, alongside taxation, help ensure that retirement income is distributed more equally than income during working life; however, the depth of old-age poverty indicates that inequality among older people persists³³.

According to the OECD, the coverage of voluntary pension plans increases with income. In this context, particularly low coverage is found in the 1st and 2nd income decile. Income level is interrelated with the aspects discussed above, as marginal work patterns often coincide with low income and women on average have lower incomes than men. Even in Germany's 'Riester' pensions, with high public subsidies focused on low income earners, coverage in the first two deciles is substantially lower than in higher income groups³⁴. Low coverage of supplementary pensions in the lower income brackets can be attributed chiefly to the inability to save because of

³² Belgian Bureau du Plan, Projections on pension adequacy in 3 EU countries, 2018, <https://www.plan.be/publications/publication-1815-fr-what-are-the-consequences-of-the-awg-2018-projections-and-hypotheses-on-pension-adequacy-simulations-for-three-eu-member-states>

³³ European Commission and Social Protection Committee, *Pension Adequacy Report 2018*, Publications Office of the EU, <https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=8084&furtherPubs=yes>

³⁴ Antolin, P., S. Payet and J. Yermo (2012), "Coverage of Private Pension Systems: Evidence and Policy Options", OECD Working Papers on Finance, Insurance and Private Pensions, No. 20, OECD Publishing, Paris. <http://dx.doi.org/10.1787/5k94d6gh2w6c-en>

the financial strains of everyday life, as well as higher replacement rates from public pensions and lower attractiveness of tax incentives³⁵.

In occupational pension plans based on collective agreements and financed primarily by contributions paid by the employer, coverage is more balanced across income deciles. Yet even in countries with quasi-mandatory coverage, such as the Netherlands, coverage gaps are mostly found in the lowest income groups. Lowest-earners can also be exempt from auto-enrolment (e.g. in the UK).

1.1.3. Conditions affecting coverage

Social partners and social dialogue

The role of social partners in pension policies is not only highly uneven across the EU but also highly limited in some Member States. This limits the development potential of occupational pensions in particular.

The social partners – on industry and single company level – play a key role in many Member States³⁶, establishing and expanding old-age protection systems, in particular occupational schemes that are normally set up on their initiative. In many Member States, social partners have an active role in managing occupational schemes. In Member States where social partners play a key role in the establishment and functioning of occupational pension schemes, a larger proportion of the employees benefit from such schemes, the level of administrative costs and charges is lower³⁷, social partners contribute to achieving balance between the interests of the employers and the employees and play an important role in building trust in occupational pension systems³⁸.

Social partners are often included in the governance structures of occupational pension institutions. In case of a paritarian representation, they are hence able to establish the right balance between the interests of the employers and the employees.

The International Organisation of Pension Supervisors (IOPS) concludes that occupational DC pension schemes and personal plans linked to employment tend to be generally much more cost effective than personal schemes where there is no direct link with employment³⁹. Collective bargaining can lead to the establishment of sector-wide occupational pension schemes (e. g. in the Netherlands, Belgium, Sweden and Germany) and has helped to reduce costs thanks to economies of scale.

³⁵ OECD (2017), *Preventing Ageing Unequally*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264279087-en>

³⁶ Natali D./Pavolini E./Vanhercke B. (2018), *Occupational Welfare in Europe. Risks, opportunities and social partner involvement*. OSE/ETUI

³⁷ Social Protection Committee's study on privately managed pension provision 2005 (6733/2/05 REV 2; SOC84, ECOFIN 62)

³⁸ For example in defined contribution (DC) schemes, the involvement of social partners can increase the confidence and may therefore lead to higher contributions. In Germany, pure DC schemes are only allowed if provided via a social partner model.

³⁹ Taejin Han and Dariusz Stańko, 2018 Update on IOPS Work on Fees and Charges, IOPS Working Papers on Effective Pensions Supervision, No. 32, December 2018: <http://www.iopsweb.org/WP-32-2018-Update-on-IOPS-work-on-fees-and-charges.pdf>

Introduction of sector wide coverage: the Dutch example

In **the Netherlands**, under the „Act on Obligatory Participation in an Occupational Pension Fund“ (*Wet verplichte deelneming in een bedrijfstakpensioenfonds 2000*) and at the request of the social partners, collective pension fund agreements can be made mandatory for the entire sector by the Minister of Social Affairs and Employment, making occupational pension schemes obligatory for the whole sector.

Conversely, in Member States with low social partner involvement, employees cannot benefit from the above advantages and occupational pensions play a marginal role in the pension system.

For those countries where occupational pensions are in the remit of industrial dialogue, the coverage of collective bargaining provides an indication of their potential development. Future development of occupational pensions may be constrained by the declining collective bargaining coverage in the EU, which fell from 68 per cent of workers in 2002 to 61 per cent in 2012⁴⁰. Furthermore, many Member States experienced the decentralisation of bargaining structures from national or sectoral multi-employer negotiations to individual workplaces. Unionisation rates, although these are not identical with collective bargaining coverage, are also dropping, in particular for younger workers.

Small or medium-sized enterprises typically find it much harder to provide occupational pensions than bigger companies. Occupational pension coverage is usually higher in the public sector than in the private sector.

Strengthening the role of member representatives and social partners: the German example

In **Germany**, social partners are at the core of occupational pension provision. Collective agreements often include provisions on occupational pensions and are an important driver of coverage and quality. German occupational pensions follow a collective approach in the accumulation and decumulation phase, where most decisions are taken by the employer (setting up a scheme or not) or the social partners on different levels (collective branch and/or company agreements), which have the capacity to consult experts and negotiate occupational agreements in the best interest of the members and beneficiaries. Small and medium-sized employers can reap similar benefits when joining in a sector-wide scheme. Although historically all German occupational pensions have been DB, recent legislative changes allow the setting-up of pure DC schemes only if provided via a social partner model. The first DC scheme of this type was announced in October 2019. The objective of this measure is to ensure that social partners will setup a good model, despite the fact that DC schemes provide no fixed guarantees. This increases

⁴⁰ European Commission, *Industrial Relations in Europe 2014*, Publications Office of the EU, <https://ec.europa.eu/social/main.jsp?catId=575&langId=en>

trust in the pension system and strengthens the role of the social partners.

Personal pensions are usually not directly linked to a labour relation; however, sometimes the employer may contribute to the employee's personal pension plan as part of the pay package, in particular in the absence of occupational pensions (e.g. in the Czech Republic).

Policies and regulations

For governments that wish to promote coverage, the main challenge is to have a holistic approach to social, labour law and fiscal regulations for all pension forms. In many Member States, the legal competences are dispersed and different authorities have partial competences to tackle pension issues; hence pension coverage is often not tackled as a whole.

Labour market policies often establish thresholds and criteria in occupational pensions (e.g. long waiting and vesting periods), which have to be met in order to be covered by an occupational pension. Many of these have been removed during the recent years, but they are maintained in some countries with the view that they help to retain the employees with the employer and thus serve an important labour market function and often nudge employers to introduce or maintain pension schemes to attract workforce. These requirements can complicate pension accrual for some workers, in particular, those in non-standard forms of work (see above), thus enhancing labour market duality.

Fiscal rules, either through advantageous tax regimes or through matching payments or fixed subsidies, are an important factor that affects the coverage of supplementary pensions, in particular for voluntary schemes (though mandatory schemes also benefit). While financial incentives are useful tools to promote saving for retirement, identifying the retirement savings needs and capabilities of different population groups could help countries to improve the design of financial incentives⁴¹.

Last but not least, policy stability and continuity is key to foster trust in supplementary pension systems and, as a result, coverage.

Information on pension perspectives

Making people aware of their pension perspectives and the possible need for supplementary saving for retirement is an important challenge, in particular since many supplementary pensions are voluntary. Another challenge is the low level of financial literacy and behavioural patterns, which are very relevant in the context of individualisation of risks (see 1.2.). Pension awareness and financial literacy, even with its limits, are key topics. A good understanding of the functioning and performance of financial markets (e.g. risk and rate of

⁴¹ OECD(2018), *Financial Incentives and Retirement Savings*, OECD publishing, Paris, <https://doi.org/10.1787/9789264306929-en>

returns) is important. However, it is a challenge for a lot of people to acquire the capabilities and competences for this understanding.

Financial awareness and information on pension entitlements: examples from Sweden, Denmark, Belgium Slovakia and Spain

In many Member States actions have been taken to increase awareness about the possible need for supplementary saving for retirement and to provide information on future pension entitlements.

Since 1999, the **Swedish Pensions Agency** (Pensionsmyndigheten) is running every year a month-long campaign raising awareness on pension entitlements by sending around 6 million “orange envelopes”⁴² with updates on individual public and occupational pension entitlements. Furthermore, people have a one-step access to an overview of their pension rights via the website ‘min Pension’ (<https://www.minpension.se/>), which also includes a simulation tool, providing information on the expected future total pension. In 2019, a new tool called ‘plan for retirement’ was launched. It will help citizens take informed decisions before retirement, notably by simulating the best possible time to retire, by indicating the amount of benefit and by clarifying certain insurance terms.

The **Danish** national tracking system, PensionInfo, gathers around 2.9 million users⁴³. It offers consumer friendly presentation, the possibility to generate a full report in PDF format summarizing users’ individual pension situation (including public entitlements) and to access the system directly via one’s online banking portal.

Belgium also has a national pension tracking system⁴⁴, through which all individuals registered in Belgium can access – information on their accrued statutory and occupational pension rights and expected statutory and occupational pension entitlements when they will retire if they continue to work at the same level.

The **Slovakian** Orange Envelop project led by a non-profit organisation⁴⁵ seeks to enable everyone to calculate at any time their expected pension entitlements at the moment they plan to retire. It provides an overview of pension rights accrued through the public, occupational and personal pensions. It is planned, that later on, it will also provide a broader picture of one’s investments, insurance, credit and real estate assets.

Private initiatives for raising financial awareness have also been undertaken. In **Spain** UNESPA, the Spanish insurance association, launched a campaign “[Ahorrar da mucha vida](#)” to raise awareness about the importance of saving and to inform citizens about different retirement

⁴² <https://www.pensionsmyndigheten.se/content/dam/pensionsmyndigheten/blanketter---broschyren---faktablad/other-languages/Annual%20statement%20orange%20envelope%202019.pdf>

⁴³ For comparison, Denmark’s total population is 5.7 million.

⁴⁴ <https://mypension.onprvp.fgov.be/fr/mypension/Pages/default.aspx>

⁴⁵ The organisation is called Orange Envelope and is a university fintech spin-off of the Univerzita Mateja Bela, <https://www.umb.sk/en/>

savings options available to them. Via an online recommendation tool, people are asked to reply to a short questionnaire to assess their risk profile and savings appetite and in turn, to determine what could be the most adequate product to meet their demands and needs.

For EU-level examples on information provision and tracking possibilities, see Chapter 2.

Recommendations to address the challenges identified in section 1.1

In view of the challenges outlined above, the High-level Group of Experts on Pensions **recommends that:**

Member States should:

- **provide financial and regulatory incentives encouraging social partners to set up collective pension plans that ensure risk-sharing between members, while respecting the autonomous competences of the social partners and the sponsoring companies;**
- consider tailored support for low-income earners including subsidies for workers and tax incentives for employers encouraging them to enrol employees;
- facilitate pension access and coverage for the self-employed through dedicated pension arrangements that reflect their variable income;
- carefully consider introduction of automatic enrolment mechanisms into occupational pension schemes; any such introduction should be broad and inclusive, seeking to ensure equal access for men and women, with well-designed opting-out possibilities and without undermining the national solidarity mechanisms;
- in order to ensure policy continuity and improve trust in pension systems, carefully evaluate the impact of envisaged reforms, taking into account in particular vulnerable groups, and avoid frequent policy changes;
- establish national fora for structured exchange on pension policies with social partners, pension providers, beneficiary representatives and independent experts.

The EU should:

- continue to support Member States' policies to ensure adequate and sustainable pensions for all, in particular through the European Semester cycle, peer review process, exchange of good practices and in-depth analysis;
- **establish a regular multi-stakeholder forum of structured exchange between social partners, pension providers, beneficiary representatives, independent experts and EU authorities on pensions.**

1.2. Challenges related to the shifting of the risk towards individuals

Pension systems contain elements of risk-sharing such as longevity, inflation, return on investment (in the funded part of the system), demography, insolvency (of sponsoring companies, individual or pension providers) and (political, regulatory and economic) instability⁴⁶. Depending on the pension type or the pension formula these risks are shared between the (national or regional) population at large, all population or a particular age group (as in DC-DB systems); a branch of industry or one or more sponsoring companies; a group of (former or active) participants to a certain pension type; a single participant in a certain plan such as an employee or an individual; the pension provider and (if applicable) the asset or investment companies.

Due to several reasons such as demographics and the corresponding public budgetary constraints experienced by the pay-as-you-go financed schemes, there have been shifts of several risks towards the individual or employee. These shifts have taken place during the last three decades. Meanwhile, the so-called three pillar model became a mainstream socio-economic pension policy model, advocated for by several international organisations, such as the World Bank in the 1990s, governments and the financial sector. Nonetheless it would be iniquitous to state these shifts to the individual are organised in a simultaneous and coordinated manner. These shifts happen mainly irrespective of one another but the combined effects are nonetheless the same: an increasing number of risks are put in the hands of individuals.

These shifts in risks represent or lead to challenges in the pension policies of the European Union and its member states.

Probably the best known and documented is the **shift of investment risk to the individual participant** linked to the shift from Defined Benefit to Defined Contribution or hybrid plans. Firstly, at pension system level, a reduction of pay-as-you-go financed DB pillars has been accompanied by an increase in funded pillars, usually based on DC schemes⁴⁷. Secondly, within occupational pillars, DB schemes are being progressively replaced by DC or hybrid plans. Moreover, a falling share of DC pension providers give a contractual minimum guarantee towards participants. These shifts and the growing risk avoidance by pension providers have various causes. Amongst others, these include demographic change, the low interest rate environment, international accounting standards and funding and corresponding solvency requirements. One dimension of this challenge is related to the compulsory retirement age in some DC schemes that can affect people retiring at a time of adverse economic situation (see section 1.4).

⁴⁶ There is also economic literature pointing at pensions as a way to cover infertility risk and hence the absence of family transfers from offspring in case of needs.

⁴⁷ In some Member States (Italy, Latvia, Poland, Sweden), pay-as-you-go public pillars, too, have been transformed into DC or hybrid schemes.

In the decumulation phase, the shift towards non-annuity products means that **longevity risk and investment risk are transferred to individuals** (see section 1.4). This shift exacerbates the challenges linked to **the growing reliance on informed decision-making by individuals**.

Given these shifts towards the individual, the availability of pension information (general and individual) and the need for financial literacy at the different stages of pension saving are important. A good and proper understanding of the pension system in which an individual participates is a suitable goal. If the participant fully understands the information then it is reasonable to assume that the information leads to less uncertainty. Information can thus be seen as a catalyst for confidence.

However, it is important not to overestimate the impact of information, as well as financial and pension education, on the real-life behaviour of all pension savers. The complexity of pensions is an inherent challenge for pension communication. There is a trade-off between the precision of pension information and its clarity. Even professionals may find it difficult to understand some legal or actuarial aspects of pension schemes, while simplified information can lead to unjustified assumptions and expectations. The widespread gap between self-perceived and real pension awareness can limit individuals' ability to take corrective action⁴⁸. Furthermore, behavioural economics research shows that retirement saving in practice may substantially defer from theoretical models that assume objective and rational individuals planning their retirement with a long-term horizon⁴⁹. Thus, **while financial literacy programmes and pension information are important, not everyone can be expected to understand how pensions work and to act on this knowledge. This is a challenge for pension policies.**

The financial crisis and the subsequent low interest environment have led in some Member States such as the Netherlands, Austria, the UK and Ireland to the **real cutting of supplementary pension rights, the lowering of indexation of annuities, the recalculation of supplementary formulas on average wages instead of on last wages and even the abolition of entire (nationwide) supplementary schemes**. A lot of individuals were and still are caught up in this lowering of benefits. The collective level of protection through occupational pensions has been eroded, especially in these countries. Together with the roll-back of statutory funded pensions in some Central and Eastern European countries (see section 1.1), the consequence is a growing dichotomy of pensions whereby only public pensions and personal savings remain.

While in classical DB schemes a lowering of benefits requires a modification of the contract (e.g. collective agreement) or can be seen as a breach of contract under certain circumstances, in classical DC schemes it can be considered as an inherent part of the pension scheme. If there are no contractual or legal guarantees such a situation can – at least from an individual point of view

⁴⁸ European Commission and Social Protection Committee, *The 2015 Pension Adequacy Report: current and future income adequacy in old age in the EU*, Publications Office of the EU, 2015, Volume I, p. 251, <https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7828&visible=0&>.

⁴⁹ Haupt M., "Analysis of expectation patterns and policy recommendations" in Stevens Y., *Communication on pension rights in Europe*. Report European colloquium 25.10.2010, Brussels, 11-23.

– be considered difficult. In order to maintain a certain envisaged pension adequacy, the lowering of the expected pension rights will require the individual to take action.

The challenge is to build trust into the supplementary pension schemes whereby economic and political instability should be countered at a more collective level. The social partners play a substantive role in the collectivisation of risks, but their leverage is being eroded by falling collective bargaining coverage rates (see section 1.1).

The growing share of the labour force trapped in unstable work patterns carry all risks at an individual level, having very little access to supplementary pensions, on top of limited protection by statutory pensions (see section 1.1). The challenge is to protect these people from their labour market condition translating into old-age poverty.

European labour markets have evolved, people change jobs more often than they used to and they remain for shorter period with the same employer. Lifetime employment with the same employer has thus become an exception for many Europeans. As a result, **many workers build small occupational pension pots spread across different providers, for which administrative costs are relatively high**. Where transfer is not possible, workers may be allowed to cash in their small pension pots when leaving the scheme, but this also means these small pension savings may be diverted to other purposes than saving for old age. This can put strain on the adequacy of workers' future retirement income. Furthermore, for small pension pots annuities are often too expensive. From an individual point of view **the challenge is thus to maintain a sufficiently high level of pension income within the vested rights when changing employers**.

In 2011, the OECD carried out an in-depth analysis of the impact of uncertainty on retirement income from DC pension plans⁵⁰, concluding that the risk of shortfall in retirement income is well above 50%, with replacement rates quite dispersed, and the risk of quite low replacement rates in worst-case scenarios. *Inter alia*, OECD calculations disclose an enormous impact of (uncertain) future rates of return on investment⁵¹.

Risk mitigation: the Belgian, Dutch, German and EU examples

The impact of different risks being shifted to the individual, can be alleviated by risk mitigation techniques. Those techniques may include life-cycling approaches, reserves and guarantees to protect against investment losses.

In **Belgium**, occupational DC plans have a guaranteed return mechanism. Therefore, the individual does not bear the investment risk. If the pension provider is not able to get a adequate

⁵⁰ Antolin P./Payet St. (2011); Assessing the Labour, Financial and Demographic Risks to Retirement Income from Defined-Contribution Pensions. OECD Journal: Financial Market Trends. Volume 2010 – Issue 2

⁵¹ Only 1 percentage point difference (5% average nominal rate of return instead of 6%) over an accumulation period of 40 years entails a 19% reduction of the resulting pension benefit (Antolin P. [2009, Private Pensions and the Financial Crisis: How to Ensure Adequate Retirement Income from DC Pension Plans. OECD Financial Market Trends, Volume 2010 – Issue 2)

average annual return, the guaranteed return has to be provided by the employer at the end of the contract. In 2019 the guarantee was 1.75%⁵².

The **Dutch** occupational pension schemes are classically known to have risk mitigation due to different risk sharing mechanisms. According to the new Financial Assessment Framework (*FTK*) introduced on 1 January 2015, pension funds providing DB schemes have to implement benefit reductions in case of persistent shortfalls but these may be distributed over a ten-year timeframe. Conversely, pension funds may only gradually provide for additional indexation in the event the funding ratio exceeds 110%. Furthermore, the investment policy in the accumulation phase of occupational DC schemes should be based on a life-cycle approach. Since 1 September 2016, accumulated capital in DC schemes may, besides a fixed life-long annuity, also be paid out as a variable annuity, where shocks may be shared collectively over a maximum of ten years (*Wet verbeterde premieregeling*). In June 2019, the government and the social partners reached a principle agreement on a new collective DC scheme, which would allow risk sharing during both the accumulation and the decumulation phase.

In **Germany**, new DC plans can only be introduced via social partner models. Only life-long annuities are possible but payment amounts can vary. As long as the coverage ratio for the pensioner population of the plan is within a range between 100 % and 125 %, pension payments can be left untouched. If the coverage ratio falls below 100 % pension amounts have to be decreased, if the coverage ratio rises over 125 %, pension amounts have to be increased. This ensures that the plan will not be underfunded and that large buffers are used for pension payments to the benefit of the pensioners⁵³.

The **EU Regulation** on a pan-European Personal Pension Product (the **PEPP Regulation**)⁵⁴ imposes risk-mitigation techniques. The objective of those techniques is that pension providers pursue an investment strategy that delivers stable and adequate future retirement income from the PEPP and a fair treatment of all generations of savers.⁵⁵

⁵² This guaranteed return signifies that all pension plans are to be considered as DB plans for international accounting standards.

⁵³ Pensionsfondsaufsichtsverordnung, § 31

⁵⁴ Regulation (EU) 2019/1238 of the European Parliament and of the Council of 20 June 2019 on a pan-European Personal Pension Product (PEPP), *OJ L* 198, 25.7.2019, p. 1-63, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2019.198.01.0001.01.ENG

⁵⁵ Article 46(1) of the PEPP Regulation: “*The use of risk-mitigation techniques shall ensure that the investment strategy for the PEPP is designed in order to build up a stable and adequate individual future retirement income from the PEPP and to ensure a fair treatment of all generations of PEPP savers*” Minimum criteria, which the risk mitigation techniques will have to meet in order to comply with Article 46(1), will be set forth in regulatory technical standards (RTS), which the European Commission will adopt.

Recommendations to address the challenges identified in section 1.2

In view of the challenges outlined above, the High-level Group of Experts on Pensions **recommends that:**

Member States should:

- protect savers, scheme members and beneficiaries by ensuring the use of appropriate risk-mitigation measures and defining appropriate default investment options where individuals have the investment choice;
- set up or facilitate national pension tracking services covering their respective pension schemes to support individuals' retirement planning;
- encourage providers to offer risk-sharing arrangements in the pay-out phase;
- explore the feasibility of introducing minimum financial education curricula to improve financial literacy and awareness of pension challenges.

The EU should:

- with a view to providing guidance to Member States, develop a principle-based blueprint for the development and design of occupational DC pensions, drawing on existing best practices;
- conduct or commission a research study looking into the different existing forms of risk sharing and risk mitigation.

Member States and the EU should:

- promote a better understanding of who bears the risks in what kind(s) of supplementary plans in order to enhance the understanding of supplementary pensions with the broader public.

1.3. Challenges affecting saving in supplementary pension schemes

Supplementary schemes are mainly of a voluntary nature and require long-term planning, thus any instability can be seen as overarching challenge for saving in supplementary pensions. The instability can be of a more economic nature due to the financial markets or of a more regulatory nature due to political and legislative changes. An environment that provides economic, financial, regulatory and policy stability over a long period of time, and the flexibility to innovate, is required for consumers and employees to save with confidence, for employers to setup and maintain occupational pension plans and for pension providers to develop and maintain the products that consumers and members want.

1.3.1. Saving capacity and the need to save

In order to demarcate the need to save in supplementary schemes, the challenge is to define an income replacement target and the expected replacement rate from all pension forms, starting from statutory pensions. While there is no sound evidence quantifying the saving capacity of households in the EU, it depends first and above all on the **presence of resources, which may limit the savings potential of some population groups.** Furthermore, pension saving has to compete against other saving needs of households.

The overall household savings rate was 10.8% in the EU-28 and 12.2% in the Euro area in 2016, with significant differences between Member States. The highest gross saving rate was recorded in Luxembourg (20.4%), followed by Sweden (18.9%) and Germany (17.1%). At the other end, 12 Member States recorded saving rates below 10% with even negative rates observed in Lithuania (-0.5%) and Cyprus (-2.3%). There are also vast differences between households. The major part of household savings in the EU are generated by only 20% of the households, while an important share of households has negative savings. The asymmetric distribution of savings largely reflects income distribution – in most countries the highest income quintile is responsible for more than 60% of total savings. The savings rate increases – not surprisingly – with income and a higher education level (Eurostat, 2018).

The low savings rates for the lowest income quintiles are in line with the poverty data from Eurostat showing that 10% of employed persons aged over 18 years are at risk of poverty after social transfers. Given these numbers it is fair to state that a lot of Europeans do not have sufficient resources for supplementary retirement saving. **It is an overarching challenge to provide Europeans with sufficient resources for old age income.**

Demarcating the required income replacement rate for an individual is challenging. How much savings are required to top up the old age retirement provision depends on such factors as life expectancy and real return on investment. A simulation of the required savings amounts for an indexed non-lifetime annuity depending on these factors is presented in Table II in the Annex.

In relation to pensions saving needs, the replacement rate from the public pillar significantly decreases the importance of supplementary saving for old age, suggesting a substitution effect between public and supplementary savings. According to OECD data, the highest private pension assets relative to GDP among EU Member States are found in Denmark (209%), the Netherlands (180%), the UK (95%) and Sweden (80%)⁵⁶, i.e. countries with moderate flat-rate public pensions and relatively high household incomes. In most of these countries, supplementary pensions have high coverage (see section 1.1.) and high mandatory contributions based on collective agreements (the UK is a slight outlier, with lower coverage and high concentration of assets.)

Women are saving less in supplementary pensions than men, contributing to the gender pension gap. Women's incomes and saving capacity is lower; furthermore, supplementary pensions have closer links between contributions and benefits than public pensions and very few redistribution mechanisms to compensate for accumulated gender inequalities linked to part-time work, maternity leave, career interruption, forced early retirement for caring duties etc.⁵⁷ As a result, in all countries with mature occupational and personal pensions, their share in women's total pensions lags far behind the share for men⁵⁸.

Pension policies can influence people's behaviour towards pension savings for better or for worse⁵⁹. The main challenge is to know and to recognize when people are better off: consuming their income today, e.g. by buying a home or saving it today to consume after retirement at least if they are financially capable of saving today. As indicated above, many people lack current resources to make substantial savings. Only the higher income groups have real saving capacity. If people have the capacity to save, the choice if, where and how much to save is often related to pension policy measures such as auto-enrolment and auto-escalation (i.e. automatic increase of contributions with time) and tax and financial incentives; these will be discussed in Chapter 4.

The legal and prudential environment should not prevent employers and employees from making contributions into occupational pension plans. In this respect the role of sponsoring companies should not be forgotten. In particular in occupational pensions, the willingness of employers to make pension promises and pay contributions have proven to be significant in many Member States. In some cases, employers may contribute to the employee's personal

⁵⁶ OECD (2017), *Pensions at a Glance 2017*. Data refer to 2016. The OECD definition of "private pension assets" includes occupational, personal and statutory funded pensions.

⁵⁷ Another gender related issue to monitor is that the impact of the judgment of the Court of Justice of 1 March 2011, *Association belge des Consommateurs Test-Achats ASBL*, Case C-236/09, ECLI:EU:C:2011:100, (Case Test Achats), which invalidated the possibility for insurers to use gender-based factors in the calculation of individuals' premiums and benefits.

⁵⁸ Bettio, F. et al (2018), *Future Risks for Gender Inequality in Old Age Income Security*, report prepared for the European Commission (unpublished)

⁵⁹ Beshears, J., Choi, J.J., Laibson, D., Madrian, B.C., Milkman, K.L., 2015. The Effect of Providing Peer Information on Retirement Savings Decisions. *The Journal of finance* 70 (3), 1161-120; Duflo, E., Saez, E., 2002. Participation and investment decisions in a retirement plan: the influence of colleagues' choices. *Journal of Public Economics* 85 (1), 121-148; Kast, F., Meier, S., Pomeranz, D., 2012. Under-Savers Anonymous: Evidence on Self-Help Groups and Peer Pressure as a Savings Commitment Device. NBER Working Paper 18417. National Bureau of Economic Research; Goldstein, D.G., Johnson, E.J., Sharpe, W.F., 2008. Choosing Outcomes versus Choosing Products: Consumer-Focused Retirement Investment Advice. *Journal of Consumer Research* 35 (3), 440-456.

pension plan. To nudge employers to make or keep making substantial contributions for their employees into a pension scheme, it is essential to create or keep a pension-friendly legal environment (social and labour law, tax law, prudential law). In many Member States, the social partners have a well-established and proven track record in collaborating towards better occupational pensions for employees.

1.3.2. The influence of the low interest rate environment

The low interest rate environment, recently experienced by most European economies, makes supplementary pension schemes more expensive by lowering the return on pension savings. This can reduce the attractiveness of supplementary pensions. In recent years, many pension funds have been able to keep up their return rates thanks to growing share prices, however a slowdown in equity markets combined with persistent low interest rates could exacerbate the challenge. A low interest rate environment can compel providers of defined benefit pension schemes to offer products with reduced guarantees. Members of defined contribution plans (without contractual or legal guaranteed return) can be forced either to pay higher contributions or to take additional investment risks to achieve the same amount in retirement.

A low interest rate environment also reduces the discount rate in DB schemes, which in turn increases the pension liabilities. In case a low interest rate environment continues for a long period of time, sponsoring companies of DB plans may have to increase contributions to the scheme. They may also close the schemes to new entrants, who will then be shifted to DC plans or will have no access to occupational pensions at all.

1.3.3. Investment strategies and the minimum return guarantees

Investment strategies must match the nature of the liabilities, including minimum return guarantees, and must ensure that the pension promises can be fulfilled. The investment strategy is dependent on the nature of the liabilities of the supplementary pension scheme, particularly on implicit or explicit guarantees. Examples of such guarantees are fixed benefits in DB schemes and minimum return guarantees on contributions into the pension scheme. Guarantees can either be based on legislative provisions or on the pension scheme contracts.

In some Member States, return guarantees are capped to prevent competition via exaggerated return promises. Apart from guarantees, other factors influencing the investment strategy include prudential regulations (e. g. maximum quota for risky assets), the size of available risk buffers (e. g. solvency capital, sponsor support, hidden reserves in book value accounting) as well as risk and return expectations for different asset classes.

1.3.4. Costs, management fees and charges

High costs and charges may unnecessarily erode the final pension outcome and discourage pension saving, if too high relative to the service provided and when these costs and charges are borne by savers/members. According to the OECD Pensions Outlook 2018⁶⁰, annual costs and charges of 1% of assets will reduce final pensions with 21.3% in DC plans (see Table III in the Annex for the impact of other levels of costs and charges).

The impact of costs depends on the nature of the plan. In a DB occupational pension plan, the impact of costs on benefits is guaranteed and borne by the sponsor and there is no direct impact on members⁶¹. In contrast, in DC pension plans the impact of costs is mostly borne directly by savers.

The level of costs is also driven by the features of the product/plan/scheme. A particular cost or charge should always be contrasted with the specific service(s) offered by the product. For instance, certain characteristics (such as guarantees and biometric risks coverage) can represent an additional financial cost, but this cost is related to the protection offered in case the extra risk covered (death, disability, morbidity...) materialises.

Last but not least, some investment costs can enhance the risk-return characteristics of the asset portfolio, if the costs are incurred to gain access to private/illiquid investment opportunities.

There is ample evidence that costs can be reduced by exploiting economies of scale in investment management and pension administration.

The multitude of EU and national legislative frameworks applicable to supplementary pensions contributes to the lack of comparable data on costs and charges of pension schemes/products/plans available. There are for example no aggregate sets of data on the supervisory costs paid by pension providers to the national regulators.

Over the past decades, EU regulation focused mainly on providers. The fact that a wide diversity of stakeholders are involved in the provision of supplementary pensions means that having an overview for all types of providers is challenging. In addition, there is a wide variety of pension products across Europe, with a variety of features, which makes it difficult to compare the costs applicable to all products⁶².

Costs, management fees and charges: the Dutch, Polish, Italian, UK and Swedish examples

Below are some examples of initiatives addressing the issue of the transparency of costs, cost

⁶⁰ OECD, *OECD Pensions Outlook 2018*, 3 December 2018: <http://www.oecd.org/pensions/oecd-pensions-outlook.htm>

⁶¹ The members could still be impacted indirectly, since costs and charges may affect the contribution and benefit levels that the sponsor is able to offer.

⁶² For one of the latest detailed overviews on costs and charges, see the OECD 2019, *Pension Markets in Focus*: <http://www.oecd.org/daf/fin/private-pensions/pensionmarketsinfocus.htm>

caps and the difficulties to compare costs.

The Dutch Federation of Pension Funds has published recommendations on administration costs, distinguishing costs for pension administration, costs for investment management and transaction costs⁶³. Pension funds have to follow the recommendations on a comply-or-explain basis.

In 2019 in the **UK**, the Cost Transparency Initiative (CTI)⁶⁴ created a set of templates and tools for the standardized disclosure of costs and charges by asset managers to institutional investors⁶⁵.

In **Italy**, to increase the transparency and to facilitate the comparison of costs applied by different kinds of pension funds, the national competent authority COVIP in 2006 introduced the so called synthetic cost indicator (SCI), which pension funds have to calculate. This indicator allows to easily display all costs paid by a member (in the accumulation phase) as a percentage of the assets of their individual account. The SCI has to be computed according to a methodology defined by COVIP, common for different types of pension funds. The calculation, which has to be done for different schemes/investment options offered by a pension fund and for 4 different time horizons (2, 5, 10 and 35 years), is made referring to a “representative” member who accumulates assets on their account according to certain assumptions.⁶⁶

Furthermore, to address the issue of excessive costs, some Member States have introduced **caps** in fees. At European level, the PEPP regulation also provides for a cost cap for the PEPP default investment option (the Basic PEPP).

In the **UK**, the charge cap is a Government set limit of the annual amount of costs that can be charged to savers investing in default arrangements within defined contribution pension schemes used for auto-enrolment. The cap applies to all scheme administration and investment charges, excluding some types of costs, like transaction costs and costs for winding up or for complying with a court order. It was introduced in April 2015 and is currently set at 0.75% of funds under management within the default arrangement. There are ongoing discussions on the need to review the cap for a number of different reasons, among which are its limited ability to reduce costs for small pension pots and that it prevents from investing in illiquid assets, which ultimately could lead to a reduction of pension return. The UK government is expected to unveil its proposals to review the cap in the course of 2020.

As of 1 January 2019, **Poland** started rolling out new additional pension plans for employees (called Employee Capital Plans; Polish acronym: PPK). According to the adopted legislation, the

⁶³ <https://www.pensioenfederatie.nl/website/engelse-website/publications-in-english/recommendations-on-administrative-costs>

⁶⁴ A partnership initiative between the Pensions and Lifetime Savings Association (PLSA), the Investment Association (IA) and the Local Government Pension Scheme (LGPS) Advisory Board.

⁶⁵ <https://www.plsa.co.uk/Policy-and-Research-Investment-Cost-Transparency-Initiative>

⁶⁶ For more information about the SCI and its methodology see <http://www.covip.it/?p=8452>; <http://www.covip.it/wp-content/uploads/INDICATORE-DEI-COSTI.pdf>

employer's and the employees' representatives have to select a financial institution to manage the PKK. To keep the costs to a minimum, the legislation provides for no entrance fees and a management fee cap of 0.6% (0.5% of net assets and 0.1% performance fee).

In **Sweden**, the occupational pension system is mainly driven by collective agreements. To ensure that savers would benefit of a good pension outcome, Sweden has a central administrative hub (managed by social partners). One of the tasks of this central hub is to select on the market the best pension managers for the employees' occupational pensions, through a call for tenders organised every five years. The selected managers have exclusive access to a large part of the Swedish occupational pension market (i.e. the sectors covered by collective agreements). This system has enhanced competition amongst pension providers and brought costs down,⁶⁷ with a positive impact on the net return for pension savers.

1.3.5. Fiscal cost of supplementary pensions

Many Member States give various tax and other incentives towards supplementary pensions, leading to a fiscal cost.

In a recent study⁶⁸, the OECD pleads for a cautious approach whereby countries should consider the fiscal space and demographic trends before introducing a new retirement savings system with financial incentives. For example, countries should be aware that introducing a pension system where only withdrawals are taxed will create a larger upfront fiscal cost. This needs to be fully disclosed and accounted for when introducing reforms to avoid creating a political backlash, especially in times of economic crisis. Finally, demographic trends matter as they may temporarily inflate or deflate the fiscal cost.

Furthermore, the same study observes that financial incentives do not target individuals with incomes below or around the poverty line, who cannot afford to save in supplementary schemes and rely on public pensions for their retirement income (see also section 1.1.2). In contrast, high-income earners usually get the lowest replacement rates from public pension schemes, but they also have a higher general propensity to save than other income groups, irrespective of incentives; in their case, tax incentives towards pension saving are likely to result in a reallocation of savings from other saving vehicles to pensions.

Explanations and examples of tax and other incentives

Member States apply different tax and other incentives to encourage the take-up of occupational

⁶⁷Better Finance, Pension Savings: the real return – 2019 Edition, page 467: <https://betterfinance.eu/publication/pension-savings-the-real-return-2019-edition/>. For further information: <https://betterfinance.eu/campaigns/the-real-return/>

⁶⁸ OECD(2018), *Financial Incentives and Retirement Savings*, OECD publishing, <https://doi.org/10.1787/9789264306929-en>

and private pensions.

Pensions can be taxed or exempt from taxes at three main moments: at the moment when the contributions are paid, at the moment when the returns on investment come in and at the time of the pay-out. Member States apply different combinations of taxation and exemption between these three moments, for example EET (contributions are exempt or tax deductible, the return on investment is exempt, the pay-outs are taxed), TEE (contributions are taxed, while investment returns and pay-outs are exempted) and TTT (where contributions, return and pay-outs are all taxed).

Furthermore, three main techniques to stimulate private pensions can be used: tax credits, matching contributions and tax deductions. Member States usually set conditions for granting specific tax or other incentives, which can be related to the duration of the savings period, the amount of contributions made (minimum/maximum) and/or to withdrawal restrictions. These techniques and conditions are not neutral when it comes to income redistribution. Tax deduction may favour high-income earners. Tax credits, matching contributions or fixed nominal subsidies can strengthen the value of tax incentives for low-income earners.

Germany uses an EET tax exemption framework for occupational pensions. The maximum tax free contributions to organisations of occupational retirement provision (IORPs) and direct insurances (Direktversicherungen) are 8% of the income ceiling of the statutory pension⁶⁹. The social security contribution ceiling is adjusted every year, adjusting the maximum tax-free contributions automatically. There is also support for low income earners as employers of those with a gross monthly income of up to €2,200 (earned through full-time or part-time work) are offered a tax incentive of 30% of employer contributions (max. €144 per year) to contribute to their employees' occupational pensions.

Riester plans, which were introduced in 2001, provide direct incentives via subsidies targeted to low income earners and (additional) tax subsidies for higher incomes. Annual subsidies are €175 per person (€200 under age 25) and €300 per child, if contributions reach a certain individual threshold.

Croatia applies a tEE system to occupational closed voluntary pension funds, lowercase t stands for partially taxed contributions, and a TEE system to personal open voluntary pension funds. Employer contributions to closed voluntary pension funds are exempt from taxation up to HRK 6,000 per year. Employee contributions into both open and closed voluntary pension funds are taxed at the marginal rate of income tax. However, the employee contributions are matched by the government based on a match rate of 15%.

Although the tax treatment of pensions in **Italy** is considered to be ETT, no double taxation occurs. Employee and employer contributions are exempt from personal income tax up to

⁶⁹ The social security contribution ceiling, Beitragsbemessungsgrenze, for 2019 is €80,400 per year.

€5,164.47 per year and TFR (Trattamento di fine rapporto) payments into the pension scheme are exempt regardless of the amount. The investment return of pension funds is taxed at a 20% rate with the exception of the return on government bonds, which is taxed at a 12.5% rate. Since 2017, returns on shares of European companies are tax free, provided they are held for at least 5 years. Pension benefits, net of the part that was already taxed in the accumulation phase, are taxed at a fixed rate of 15% with a reduction of 0.3% for every year of participation after 15 years. Early withdrawals (e.g. for buying a house) are generally taxed at a rate of 23%.

In **Austria** in 2004, the so-called ‘premium-aided pension savings scheme’ (Prämienbegünstigte Zukunftsvorsorge) has been introduced for personal pension savers. Pay-out options range from taxable lump sum to tax-free lifelong annuities. As key incentive, the state offers a premium calculated as a percentage of the contribution paid by the saver (for contribution not exceeding €2,875.18 per year/2019). In 2012, in the context of widespread criticism about the design and poor performance of the schemes and in view of the government’s aim to reduce public spending, the state premium was lowered, from 8.5% to 4.25%.

1.3.6. Falling contributions

The shift from DB to DC schemes is frequently accompanied by falling contributions. In most cases, employers do not contribute to DC plans as much as they had to contribute to DB pension plans⁷⁰. Research on the development of occupational pension schemes in Austria discloses that, while coverage has significantly increased over the past 20 years, average contributions paid into the new DC schemes is much lower compared to former DB schemes. As a result, today’s workers covered by occupational pension schemes on average are expected to get significantly lower occupational pensions compared to benefits from DB schemes. Estimates suggest that for a large number of employees currently covered by an Austrian occupational pension scheme accumulated pension capital until retirement will be very low, in many cases probably below the ceiling for lump sum pay-outs (i.e. €12,600 in 2019)⁷¹.

1.3.7. Trust and understanding

Trust in pension systems, and supplementary pensions in particular, is paramount to convince people to save for their old age in pension schemes. Frequent policy and regulatory changes as well as unrealistically high return assumptions promised by some policy makers and providers contribute to a **decline in trust in pension systems**.

⁷⁰ OECD (2012), Pension Outlook 2012, p. 190 (FN 9), https://www.oecd-ilibrary.org/finance-and-investment/oecd-pensions-outlook-2012_9789264169401-en

⁷¹ Url T. (2013), Volkswirtschaftliche Daten zur Pensionsvorsorge in Österreich. In: Umik S./Pfeil W. (eds.), Betriebliche Altersvorsorge in der Krise, Wien, Manz-Verlag

The general level of trust in pension systems is higher in the EU-15 than in the more recent Member States. With rapidly ageing populations, most Central and Eastern European Member States transformed their pension systems by channelling part of social security contributions into statutory funded DC pension schemes. These reforms shifted risks associated with financing retirement from institutions towards individuals (see section 1.2) and, in some countries, were fully or partially reversed amid criticism of their social and economic impact⁷², contributing to the decline in trust.

Studies show a decline in trust in both the public and supplementary pensions by younger people⁷³. The generational cleavage appears to be most severe in Austria, France, Germany, Lithuania, Hungary and Slovenia.

Personal pensions face a particular trust challenge. According to the 2018 European Commission Consumer Market Scoreboard of investment products, private personal pensions and securities rank second last among 25 services under scrutiny⁷⁴. The report does not, however, explore the basis of this scepticism or experiences that may have led to it.

Examples of adverse reforms, which could undermine trust in the pension system

Frequent reforms of the pension system, as well as other reforms affecting pension savings, could lead to decline in trust. Below are some examples of such reforms.

In **Ireland** as a result of the financial crisis, for the period 2011-2014, the government imposed on pension funds a special tax, pension levy, of 0.6% of the market value of the assets of all Irish pension funds. This reform led to decrease in people's trust in pension funding.

In **Italy**, as of 1 January 2015, the substitute tax rate due on the operating income accrued by **Italian** pension funds in a year has been increased from 11.5% to 20%. However, a lower 12.5% tax rate is applicable to some categories of income, such as is operating income deriving from Italian government bonds, other public debt instruments, bonds issued by countries which allow an adequate exchange of information with Italy and securities issued by international organizations incorporated in accordance with international treaties. Since 2017, returns on shares of European companies are tax free, if held for at least 5 years. Consequently, pension funds may be pushed, for fiscal reasons, to invest in sovereign debt or European equities at the expense of other investments.

⁷² ILO (2018), [Reversing Pension Privatizations. Rebuilding public pension systems in Eastern Europe and Latin America](https://www.ilo.org/secsoc/information-resources/publications-and-tools/books-and-reports/WCMS_648574/lang-en/index.htm): https://www.ilo.org/secsoc/information-resources/publications-and-tools/books-and-reports/WCMS_648574/lang-en/index.htm .!!DOxrgLBm!Xzqig34fj6Gbtju4LfQ4ARjeU4okOOyFtBPN8vX3-8e5SOqjdnYKDVrb5VdxtCFSRD53xzFKyA\$

⁷³ Keck, Wolfgang und Agnes Blome (2008)

⁷⁴ European Commission, Consumer Market Scoreboard: Making Markets Work for consumers, 2018 edition, p. 17: <https://ec.europa.eu/info/sites/info/files/eujus15a-1816-i02 - the consumer markets scoreboard 2018 - accessibility final.pdf> .

In the context of increasingly complex multi-pillar pension systems and growing labour mobility, **citizens may struggle to understand how the pension system works and what their saving needs are.** The ongoing changes in pension systems make them harder to understand for citizens. At the same time, many recent reforms have improved the sustainability of public pensions at a cost to their adequacy. If people do not sufficiently understand the impact of these reforms, they may fail to take the necessary steps to maintain an adequate income in retirement.

Provision of information alone is not sufficient to create pension awareness. If citizens are not sufficiently financially literate, or if the information is not provided in an easy-to-understand way, it may not be conducive to taking optimal decisions. In some cases, the reforms have been accompanied by a rise in financial education programs, however there are limits to what financial literacy measures can achieve (see also 1.2).

Trust and understanding – default options: the UK and EU examples

A way to deal with the growing complexity of pension products, and hence to increase trust in the pension system is to make use of **default** options where investment choices can be made by the saver. Without prejudice to the existence of other investment options, well-designed default investment options will support individual savers unable or hesitant to make investment decisions and can contribute to ensuring adequate pension outcomes.

For instance, legislation in the UK requires pension schemes with auto-enrolment to provide for **default investment options.**

At EU level, the **PEPP Regulation** introduces a **default investment** option, Basic PEPP. Moreover, the number of investment options offered is limited to six in order to prevent so-called choice overload for savers due to too many options.

Recommendations to address the challenges identified in section 1.3

In view of the challenges outlined above, the High-level Group of Experts on Pensions **recommends that:**

Member States should:

- define an overall income replacement target covering all types of pensions in the country, based on realistic assumptions;
- nudge and incentivise employers and employees to make or maintain appropriate contributions to occupational pension schemes;
- keep tax incentives stable over time to increase individuals' confidence in the system;
- **reserve tax and/or financial incentives in the savings phase for supplementary pensions meeting minimum quality requirements. These incentives should reflect the diversity in characteristics of types of pensions and the related social policy of a Member State;**
- take into account the distributional effects when designing fiscal incentives or subsidies.

The EU should:

- develop a common EU methodology in order to allow Member States to measure the current and long-term budgetary effects of the fiscal treatment of supplementary pensions;
- renew the EU Strategic engagement for gender equality; explore the possibility to extend the indicator of gender gap in pensions to cover all supplementary pensions.

Member States and occupational pension providers should:

- **ensure that occupational pensions provide pension credits for career breaks linked to child care or other caring responsibilities, protecting the accrual of pension rights and encouraging equal sharing of care responsibilities between women and men. Such credits may be financed from various sources.**

1.4. Challenges affecting the pay-out phase

In most EU countries pension income is mainly paid by statutory or quasi-mandatory occupational schemes with no or very limited choice regarding the pay-out phase. With the rising role of supplementary pension schemes in which the member can choose between different alternatives (e.g. how contributions are invested and paid out), the responsibility to make the right choice lies now more and more with the beneficiaries and it is important for them to get a good understanding of the various options available. Furthermore, **the current changes in the pay-out landscape are taking place against the background of increased life expectancy, low inflation rate and capital market risks, putting additional pressure on retirement savings and making it even harder for individuals to assess and manage the longevity risk.**

1.4.1. Background

Pension decumulation practices in the EU have been recently surveyed in the 2014 EIOPA fact-finding report⁷⁵, which covered start of decumulation, information disclosure, costs and charges on benefit payments, tax treatment and types of annuities. The 2016 Financial Services Users' Group (FSUG) study provided more detailed analysis of decumulation practices in selected countries⁷⁶.

There is an increasing variety among pension decumulation practices across the EU. While annuities remain most common, they now come in various shapes and forms to adapt to evolving legislation and pension reforms: mandatory vs optional annuitisation, lifetime, guaranteed, escalating, enhanced, deferred annuities, etc. In recent decades, a variety of non-annuities decumulation products have also been developed: lump sums, drawdowns, mixed drawdown-annuities, etc. Finally, since the take-up of supplementary pensions results in a growing number of people reaching retirement age with a pension pot to decumulate, new financial products are being offered through active marketing as innovative decumulation alternatives: repayment of mortgages and other debts, buy-to-let property investment, interest-bearing saving accounts, deferred or immediate long-term coverage, funeral insurance etc. In general, the more important role supplementary schemes play in old-age income replacement, the more restrictive pay-out conditions tend to be, though exceptions increasingly appear⁷⁷.

Decumulation mostly starts between the age of 50 and 70. Like statutory pensions, supplementary pensions increasingly adapt to life expectancy and standard retirement age is now in some countries defined around 67-68. Early start of decumulation is possible in most EU countries, but scheme rules often stipulate conditions and limit early withdrawals to specific

⁷⁵ EIOPA's Fact Finding Report on Decumulation Phase Practices, 27 October 2014, https://eiopa.europa.eu/publications/reports/eiopa-bos-14-193_eiopa_s_fact_finding_report_on_decumulation_phase_practices.pdf

⁷⁶ Pension Decumulation Practices in four EU countries, FSUG, October 2016, p. 28, <https://op.europa.eu/en/publication-detail/-/publication/d3cf91fd-e6ba-11e6-ad7c-01aa75ed71a1/language-en/format-PDF>

⁷⁷ 2018 Pension Adequacy Report

hardship situations defined by national laws (unemployment, death of spouse or excessive debt). Some schemes allow early retirement for disability, especially where biometric risk coverage is mandatory by law. In case of death before the decumulation phase, the designated beneficiaries will usually receive benefits in the form of a lump sum, annuity or conveyance of the accumulated assets. Again, this is linked to additional biometric risks coverage such as longevity or morbidity risk.

Only some countries allow continued contributions to the scheme after the payment of annuity has started. Some schemes allow to delay decumulation by transforming part of the accumulated capital into an annuity, while the beneficiary continues paying contributions to the same arrangement to buy additional (separate) annuities later.

According to a study by European Actuaries (AAE)⁷⁸, Member States that have had greater reliance on supplementary pensions tend to have more developed decumulation markets than Member States that have traditionally relied heavily on state pensions.

1.4.2. Challenges linked to choosing the most suitable decumulation product

According to the FSUG study⁷⁹, consumers favour guaranteed annuities and drawdowns because they usually offer the best value for money and allow transfer of part of their capital after death. The tax incentive/relief attached to certain forms of pay-out is another important element factored in by savers. Yet choosing the right annuity is complicated since most individuals underestimate their longevity and income needs in very old age. Retirees must factor in a broad range of considerations such as expected needs, incentives granted for specific decumulation options, other retirement incomes as well as expected financial markets performance. For small pension pots, annuities are too expensive.

Avoiding excessive administrative costs for small pots: the EU, German and Dutch examples

In order to avoid excessive administrative costs on small pension pots, **Directive 2014/50/EU**⁸⁰ allows Member States to set a threshold under which pension schemes may be given the option not to preserve such vested rights but, instead, with the worker's informed consent, to pay the outgoing worker a capital sum equivalent to the value of the vested pension rights.

At national level, **Germany** has restricted the cash out option only to workers moving abroad and continues using a higher threshold under which pension pots can be cashed out without

⁷⁸ The Actuarial Association of Europe, *Survey of Decumulation Regimes*, December 2014, https://web.actuaries.ie/sites/default/files/story/2015/03/AAE_Decumulation_Report_Feb2015.pdf

⁷⁹ *Pension Decumulation Practices in four EU countries*, cited above

⁸⁰ Directive 2014/50/EU of the European parliament and the Council of 16 April 2014 on the minimum requirements for enhancing worker mobility between Member States by improving the acquisition and preservation of supplementary pension rights, OJ L 128, 20.4.2014, p. 1-7, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0050>

individual consent of the employees concerned, when they leave the company but remain in the country.

In the **Netherlands**, whereas in the past occupational pension providers were allowed to unilaterally pay out small pensions, since 1 January 2019, they may automatically transfer small pensions (more than €2 and less than €484.09 gross per annum) to the worker's current pension provider. In this way, mobile workers' pension rights will be spread over fewer pension pots. Only when the outgoing worker does not dispose of a new pension provider within 5 years, the old pension provider may pay out the small pension with the worker's permission. Very small pensions (€2 or less gross per year) will lapse from 1 January 2019 in order to avoid excessive administrative costs for small pots.

While in some Member States (e.g. the UK), annuities are progressively replaced by lump-sum payments, many individuals are not sufficiently equipped to deal with them, and lump sum payments may not be adapted to the needs of all population groups. Individuals may favour shorter-term needs (such as liquidity and immediate consumption) over longer-term ones, though studies show this is not always the case⁸¹. Behavioural biases such as loss and risk aversion, inertia and procrastination also impact individuals' decision-making process and attitude toward financial planning. In some cases, lump-sum pay-outs can be invested in annuities (except for small amounts) or alternative solutions such as repaying debts/mortgages, adapting the home to dependency needs, long-term care insurance (for smaller pots).

The increasing complexity of decumulation products is far too complicated to understand for many retirees. In the UK, the introduction of enhanced annuities and greater flexibility have resulted in making choice more difficult for retirees⁸².

Covering longevity risk: the German example

In **Germany**, in the decumulation phase, life-long benefits (i.e. annuities) are generally required in order to qualify for the EET tax exemption framework. The objective is to ensure that people do not outlive their savings. For Riester pensions, it is also possible to receive up to 30% of the available capital as a lump sum and/ or to receive instalments combined with an annuity, from the age of 85 onwards at the latest. Riester capital can also be used to finance new housing or for renovations if used by the Riester saver (Wohn Riester).

⁸¹ See, for example, Berghman, J. & Peeters, H., [Pension Protection in Belgium](https://www.scribd.com/document/81691440/Berghman-J-Peeters-H-2012-Pension-Protection-in-Belgium-Text-prepared-for-the-workshop-on-the-occasion-of-the-honorary-degree-of-John-Myles), 2012, <https://www.scribd.com/document/81691440/Berghman-J-Peeters-H-2012-Pension-Protection-in-Belgium-Text-prepared-for-the-workshop-on-the-occasion-of-the-honorary-degree-of-John-Myles>

⁸² [Pension Decumulation Practices in four EU countries](#), cited above

Savers may find it difficult to decide among a wide range of options available to them because of uncertainty about life-expectancy, investment return, inflation, etc., and because financial literacy is generally low across Europe, with however significant differences⁸³. According to the OECD⁸⁴, financial literacy levels are often lower among women than among men, yet little is done to provide women with gender-specific support to help them manage their greater financial risks. Provisions for survivors vary a lot among schemes.

There is a lack of adequate information and advice on decumulation issues, including the risks to consider when planning retirement income pathways⁸⁵. Pension information and awareness policies tend to pay less attention to the decumulation phase than to the enrolment and saving phases. Employers may provide information and support in an occupational context. Product providers and independent advisers are also common sources of information and/or advice. In a number of countries, there are statutory requirements applicable to providers for disclosure of information to members at retirement, however there is no convergent European approach, mainly because advice is circumstantial and decumulation practices vary widely. Recent EU regulation⁸⁶ introduces general requirements for providers to inform members about the available pay-out options.

Information and advice on decumulations issues: the EU and Dutch examples

The **IORP II Directive**⁸⁷ introduces the requirement to provide, in due time before the retirement, information about the pay-out options available in taking their retirement benefits. IORPs are also required to periodically provide, during the decumulation phase, beneficiaries with information about the benefits due and related changes.

Under the **PEPP Regulation**, in addition to the PEPP Benefit Statement, providers shall provide savers, during the pre-retirement phase with information about the upcoming start of the decumulation phase, the possible forms of out-payments and the possibility to modify their chosen form of out-payment.

During the decumulation phase, providers shall provide annually beneficiaries with information about the benefits due and the corresponding form of out-payments. Where the saver continues to make contributions or to bear investment risk during the decumulation phase, the provider

⁸³ OECD, *Financial education in Europe. Trends and recent developments*, April 2016, <http://www.oecd.org/education/financial-education-in-europe-9789264254855-en.htm>

⁸⁴ OECD, *Addressing Women's Needs for Financial Education*, 2013, http://www.oecd.org/daf/fin/financial-education/OECD_INFE_women_FinEd2013.pdf

⁸⁵ *AAE Survey of Decumulation Regime*, cited above

⁸⁶ Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs), OJ L 354, 23.12.2016, p. 354, known as IORP II Directive; the PEPP Regulation, cited above.

⁸⁷ It replaces Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision, OJ L 235, 23.09.2003, p. 10, known as IORP I Directive.

shall continue providing the Benefit Statement containing the relevant information. For the Basic PEPP, at the start of the decumulation phase, the provider shall offer the saver personal advice on the most suitable use of the capital accumulated in the PEPP sub-accounts.

At national level, in the **Netherlands**, since January 2018, all pension providers offering a choice between fixed or variable pension benefits are legally required to use a [standardized information document](#)⁸⁸ when communicating with DC participants schemes. This document supports the decision making process based on individual circumstances comparing different characteristics of different pay-out options: pros and cons, monetary projections, risks indicators. The document can be provided digitally and/or on paper.

1.4.3. Other challenges linked to the decumulation phase

Administrative and investment costs can impact the benefits, in particular annuities. The 2015 EIOPA study⁸⁹ concluded that the types of costs and charges and applicable rules during benefit payment vary significantly among Member States, partially linked to the prevailing type of providers and/or schemes. In many Member States, costs and charges during the decumulation phase are not regulated, and only a few apply some kind of limit or restriction. Regarding disclosure rules on costs and charges, the legal frameworks mainly refer only to principles.

The impact of investment costs on decumulation is also far from negligible. In a recent study⁹⁰, the Danish Money and Pension Panel found that an increase of investment costs by 0.5% requires to postpone withdrawal by about 2 years to maintain the same lifelong annuity (see Figure I in Annex).

The best time to retire and decumulate is increasingly difficult to choose for individuals who are covered by statutory and supplementary pension schemes, due to the varying rules regarding eligibility age and early decumulation options. Setting a strict decumulation age presents another challenge: in DC schemes, age cohorts that reach the decumulation age at a moment when market conditions are bad may find themselves at a disadvantage. As a consequence of the 2008 financial crisis, some people lost important pension capital merely because they had to retire at the wrong moment⁹¹.

⁸⁸ https://www.verzekeraars.nl/media/4224/17020_vvv_pensioenformulieren_2017.pdf

⁸⁹ [EIOPA Report on costs and charges of IORPs](https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-266-Final_report_on_costs_and_charges_of_IORPs.pdf), EIOPA-BoS-14/266, 2015, https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-266-Final_report_on_costs_and_charges_of_IORPs.pdf

⁹⁰ The Danish Money and Pension Panel, *Explaining investment costs*, January 2018

⁹¹ Whitehouse, E., *Pensions During the Crisis: Impact on Retirement Income Systems and Policy Responses*, The Geneva Papers on Risk and Insurance. Issues and Practice, Vol. 34, No. 4, SPECIAL ISSUE ON THE FOUR PILLARS (October 2009), pp. 536-547

Flexibility of decumulation choices: the Dutch and Portuguese examples

To address issues related to strict decumulation rules, in the **Netherlands**, a recent reform introduced variable annuities, enabling consumers to buy a temporary annuity while waiting for better interest rates to buy a lifelong annuity. This reform seeks to ensure that beneficiaries will not be disadvantaged because they reach retirement age at a moment of low interest rates.

The decumulation rules in **Portugal** distinguish between the source of the accumulated capital at retirement⁹². Depending on the plan rules, up to 1/3 of the capital derived from employer contributions may be paid as a lump sum. The other 2/3 have to be paid in the form of a life annuity. If the monthly pension is less than one-tenth of the statutory monthly minimum wage, the capital can be paid as a lump sum, upon agreement between the pension fund management entity, the employer and the employee. The accumulated amount of employee contributions (including investment in return) can be paid out as an annuity, a lump sum or both.

The **inflation risk** may erode the value of the benefit over time, unless the benefit is adjusted to inflation.

Another risk which the beneficiaries can face during the decumulation phase, is the risk of fraud. In 2018 through its Report on Senior Investor Vulnerability, the International Organization of Securities Commissions⁹³ (IOSCO) raised awareness of the increased vulnerability of senior investors and ways to improve their protection. The biggest risks to senior investors are seen to be unsuitable investments, financial fraud committed by a non-family member and diminished cognitive capability that affects their financial decision-making⁹⁴. The IOSCO calls for investor protection programmes to introduce specific strategy or focus aimed at protecting seniors as the programmes covering all investors are not adequate to protect **older persons from fraud and abuse**.

In the Fukuoka Policy Priorities on Ageing and Financial inclusion⁹⁵, the G20 countries committed to take action to better protect and support older persons who face higher risk of fraud and abuse as a consequence of digitalisation, poor financial and digital literacy, social isolation and being forced to rely on relatives or friends. In the Policy Priorities, it is stated that older persons with a pension pot to decumulate need access to independent guidance that will take on board their individual situation and expected longevity.

⁹² See EIOPA's Fact Finding Report on Decumulation Phase Practices, EIOPA-BoS-14/193, 27 October 2014,

https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-193_EIOPA_s_Fact_Finding_Report_on_Decumulation_Phase_Practices.pdf

⁹³ IOSCO Report on Senior Investor Vulnerability, 2018, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD595.pdf>

⁹⁴ Other notable risk factors are complex products, deficient financial literacy, and social isolation.

⁹⁵ G20 Fukuoka policy priorities on Aging and Financial Inclusion, 2019, <https://www.oecd.org/g20/summits/osaka/G20-Fukuoka-Policy-Priorities-on-Aging.pdf>

Danger of fraud and abuse: the UK example

Retirement related fraud is a particularly important issue in the UK, where the Financial Conduct Authority (FCA) and the Pensions Regulator (TPR) have recently joined forces to warn the public about fraudsters targeting people's retirement savings. This warning comes as new research suggests that 42% of pension savers could be at risk of falling victims of pension scammers. They even estimate the figure to be around 60% of those looking for products with high returns in today's context of low interest rate⁹⁶. A ban on pension cold calling came into force in 2019. Firms that break the rules could face penalties of up to half a million pounds. The FCA policy action is completed by a public campaign⁹⁷, which includes advice and simple steps to protect oneself from pension scams. Pension savers can also test how ScamSmart they are by taking a new quiz on the ScamSmart site⁹⁸.

Finally, possible **gender discrimination** could arise during the decumulation phase.

Gender discrimination in the pay-out phase

This issue of gender discrimination has been addressed by the European Court of Justice and the EU institutions in relation to Directive 2004/113/EC⁹⁹.

In January 2012 the European Commission issued Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the ECJ judgment on Case Test-Achats (C-236/09). The Guidelines state that as of 21 December 2012, the unisex rule contained in Article 5(1) must be applied without any possible exception in relation to the calculation of individuals' premiums and benefits in new contracts. Yet the Court judgment does not prohibit the use of gender as a risk-rating factor in general. Such use is allowed in the calculation of premiums and benefits at the aggregate level, as long as it does not lead to differentiation at individual level.¹⁰⁰

⁹⁶ <https://www.fca.org.uk/news/press-releases/5m-pension-savers-could-put-retirement-savings-risk-scammers>

⁹⁷ [Ibid.](#)

⁹⁸ <http://www.fca.org.uk/scamsmart>

⁹⁹ Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services, OJ 373, 21.12.2004, p. 37-43, [EUR-Lex - 32004L0113 - EN - EUR-Lex](#)

¹⁰⁰ Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the judgment of the Court of Justice of the European Union in Case C-236/09 (Test-Achats), OJ55, 13.1.2012, <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2012:011:FULL&from=EN>

Recommendations to address the challenges identified in section 1.4

In view of the challenges outlined above, the High-level Group of Experts on Pensions **recommends that:**

Member States should:

- promote awareness of the choices and risks at pay-out, including longevity and inflation risks, through financial education initiatives;
- ensure that the available pay-out options adequately cover the longevity risk, taking into account the national social protection system;
- ensure that savers benefit from personalised advice before retirement on the sustainable use of the capital accumulated, including a recommendation on the optimum form of pay-out taking into account their specific situation/needs;
- in case of lump-sum payments, promote competition and cost-efficient provision of pay-out products for plan members;
- **reserve tax and/or financial incentives in the pay-out phase for supplementary pensions meeting minimum quality requirements. These incentives should reflect the diversity in characteristics of types of pensions and the related social policy of a Member State.**

The EU should:

- propose a set of actions to tackle financial abuse and fraud during the decumulation phase of supplementary pensions.

Challenges related to the EU dimension of supplementary pensions

2.1. Challenges related to occupational pensions

2.1.1. Background

The occupational pensions' landscape in Europe is very diverse and is closely linked to the national pension rules and systems. This diversity in the national pension systems, coupled with the diversity of the applicable legislative regimes, can be challenging from the European perspective.

Pension systems design is a competence of the Member States. While the main responsibility for achieving adequate and sustainable retirement income therefore remains with the Member States, in order to promote and facilitate the achieving of this goal, a range of legislative and policy instruments have been developed at EU level. Supplementary pensions are also subject to different EU rules on matters related to the functioning of the internal market, the protection of workers' rights and discrimination issues.

In Europe there are mainly two types of occupational pension providers – institutions for occupational retirement provision (IORPs) and insurance undertakings.

IORPs are regulated by the IORP II Directive, which was adopted in 2016 and had to be transposed in the national legal orders by 13 January 2019. IORPs are institutions for complementary occupational retirement savings, which operate funds based on contributions coming from the employer and the employee. In many Member States, social partners have an active role in the setting up and managing of IORPs.

The IORP II Directive sets minimum harmonisation rules¹⁰¹, in order to accommodate the diversity of the national pension systems, while at the same time fostering the creation of the internal market for occupational pension schemes.

The insurance sector is regulated by the Solvency II Directive¹⁰² which is based on the full harmonisation approach.

¹⁰¹ It also enhances the rules on governance and risk management and transparency of information provided to beneficiaries and provides rules to facilitate cross-border activities and transfer of IORPs.

2.1.2. Challenges related to cross-border activity of providers

Occupational pension providers are still facing obstacles when pursuing cross-border activities.

Currently, almost all IORPs are active only in one Member State. The IORP II Directive enables IORPs to take advantage of the internal market by accepting sponsorship and managing an occupational pension scheme from a company located in another Member State. One of the potential benefits for operating cross-border, is the opportunity for an IORP with activities in several Member States to be able to benefit from economies of scale, while at the same time centralising its management and fulfilling harmonised requirements.

However, few IORPs are inclined to develop cross border activities for different reasons. Firstly, from an investment point of view the European freedom of capital allows IORPs to invest internationally irrespective of cross border activities. Sponsoring companies have been able to capture part of the benefits of the internal market by pooling assets from pension schemes in different Member States through cross-border investment funds. Furthermore, IORPs that are active in another Member State have to comply with the legal requirements on social and labour law.

IORPs wishing to engage in cross-border business still experience practical challenges and obstacles. These obstacles can be broadly summarised as follows¹⁰³:

(i) Administrative procedures

The administrative and supervisory procedures for pursuing cross-border activity are sometimes still considered as cumbersome and lengthy.

Some IORPs still consider the administrative and supervisory procedures for pursuing cross-border activity lengthy and complex and see them as an obstacle for cross-border business¹⁰⁴. This can be due to different reasons related to difficulties with the administrative procedures for carrying-out cross-border activity. For example, EIOPA's Occupational Pensions Stakeholder Group has identified,¹⁰⁵ among others, the following difficulties: differences in the cross-border procedures for IORPs and for insurance companies according to the insurance regulation¹⁰⁶,

¹⁰² Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 335, 17.12.2009, p. 1, <https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32009L0138>

¹⁰³ EIOPA conducted a survey among cross-border practitioners, enquiring about the barriers to cross-border occupational pension provisions. The results have been published in the 2017 Market development report on occupational pensions and cross-border IORPs, EIOPA-BoS-18/013, 30 January 2018, <https://eiopa.europa.eu/Publications/Reports/EIOPA-BOS-18-013-2017%20Market%20Development%20Report.pdf>

¹⁰⁴ Ibid.

¹⁰⁵ [OPSG Feedback statement to EIOPA about the Budapest Protocol: cross-border authorization process and the need to change the Protocol, 30 November 2016, https://eiopa.europa.eu/Publications/Stakeholder%20Opinions/VI.%20EIOPA-OPSG-16-22%20Feedback%20Statement%20Budapest%20Protocol.pdf](https://eiopa.europa.eu/Publications/Stakeholder%20Opinions/VI.%20EIOPA-OPSG-16-22%20Feedback%20Statement%20Budapest%20Protocol.pdf)

¹⁰⁶ When an authorised IORP wishes to commence a cross-border activity for a new sponsoring undertaking, it must be agreed *a priori*, whereas in comparison the agreement is *a posteriori* for insurance companies according to the insurance regulation.

which could lead to confusion; risks of misunderstanding and mistakes when exchanging documents between home and host authorities¹⁰⁷; the need to re-apply for permission to operate as a cross-border plan for multinational corporations when a subsidiary is sold, reorganised or ceases or becomes a sponsor for the cross-border plan; and the fact that certain parts of the Budapest Protocol on cross-border cooperation of 2009¹⁰⁸ were not followed by the national competent authorities, which has resulted in dissatisfaction and delayed the development of cross-border IORPs.

The new cross-border procedures, introduced by the IORP II Directive and the Decision on the cross-border collaboration between the National Supervisory Authorities and EIOPA (which replaced the Budapest Protocol)¹⁰⁹, aim at resolving these issues and provide practical examples and templates. It remains to be seen to what extent these developments will effectively address this challenge.

Strengthening cross-border cooperation: the EU example

The 2018 **Decision on the cross-border collaboration** of national competent authorities (NCAs) with respect to the IORP II Directive, adopted by the EIOPA Board of Supervisors, aims at strengthening the cross-border cooperation between NCAs related to IORPs cross-border activities and cross-border transfers, at identifying good practices and at fostering supervisory convergence. It promotes greater transparency towards IORPs, which will be duly informed by the NCAs about their expectations, such as the justification and decision linked with the provision of information to the NCAs. It also contains appendices with information and materials, such as templates, flow-charts and examples of cross-border activities¹¹⁰.

(ii) Funding standards

IORPs operating in a Member State where national law allows them to be less than fully funded may not be willing or able to fulfil the requirement to be fully funded in cross-border situations.

Another challenge for cross-border IORPs is the requirement to be fully funded at all times¹¹¹. The intention of this requirement is to safeguard members' protection and prevent regulatory

¹⁰⁷ These can be due to the fact that they have not used a common language in their communications.

¹⁰⁸ Protocol relating to the Collaboration of the Relevant Competent Authorities of the Member States of the European Union in particular in the Application of the Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORPs) Operating Cross-Border Activity (CEIOPS-DOC-08-06-Rev1) (Budapest Protocol)

¹⁰⁹ EIOPA, Decision on the collaboration of the competent authorities with regard to the application of the IORP II Directive, EIOPA-BoS-18/320, 27 September 2018: https://eiopa.europa.eu/Publications/Protocols/EIOPA-BoS-18-320_Decision_IORPII_cross-border_collaboration.pdf; for further information on the decision see <https://eiopa.europa.eu/publications/protocols-decisions-and-memoranda>
¹¹⁰ <https://eiopa.europa.eu/Pages/News/EIOPA-promotes-greater-transparency-towards-IORPs-on-cross-border-activities.aspx>

¹¹¹ Article 14.3 of the IORP II Directive requires the technical reserves to be fully funded at all times. If this condition is not met, the competent authority of the home Member State has to intervene and require the IORP to immediately draw up appropriate measures and implement them without delay in a way that members and beneficiaries are adequately protected. With regard to cross-border transfers, Article 12.7(d) and (e) of the IORP II Directive stipulates that at the date of the transfer technical provisions should be fully funded and "the assets to be transferred are

arbitrage considering the diversity of rules applicable at national level which in some Member States allow underfunding in conjunction with a recovery plan.

As DB schemes have been established in times with far higher interest rates, some of these schemes run into financing problems in the current low interest world. The increase in life expectancy has put further pressure on funding positions. According to national funding requirements and using national valuation standards - which are very diverse across Europe - DB pension funds have in aggregate a shortfall of 17% of liabilities¹¹² (or €500bn), which are unevenly distributed throughout EU.¹¹³ Restoring the sustainability of pension funds is a difficult matter since this can only be achieved by increasing sponsor payments or employee contributions, which may often not be feasible, or reducing benefits. This also raises the issue of a fair distribution of the burden between the older and younger generations. In many cases, however, social partners have responsibly managed to find consensus and to negotiate fair recovery plans for underfunded IORPs. Sustainability may of course also be restored by improving investment returns.

The requirement to be fully funded at all times if pursuing cross-border business is an obstacle for underfunded IORPs. As there are no interest rate or longevity guarantees in pure DC schemes, the shift to DC pensions will alleviate the obstacle of the fully funding requirement, while at the same time shifting investment risks to the individual. The overwhelming majority of accrued occupational pension rights and assets are in DB pensions. Recently, in many countries, DB schemes have been closed for new members and sometimes for further accruals. Still, DB schemes will continue to be around for a considerable time even in countries that transition towards DC and hybrid schemes.

(iv) Different social and labour laws (SLLs)

While cross-border IORPs are subject to the rules (prudential, organisational, SLL) of their home Member State, they also have to fully comply with SLL of the host Member State. The challenge is to combine the social protection of members in a scheme at the lowest administrative cost with the least complexity.

SLL is an essential basis for protecting the social rights of members and beneficiaries of occupational pension schemes. For some Member States, SLL also reflects the important role of the social partners in the structure of the pension system.

Cross-border IORPs are subject to the prudential regulation of the home Member State, but have to comply with the social and labour law (SLL) of the host Member State. SLL remains a

sufficient and appropriate to cover the liabilities, technical provisions and other obligations and rights to be transferred, in accordance with the applicable rules in the home Member State of the transferring IORP.”

¹¹² EIOPA, 2017 IORP Stress Test Report, EIOPA-BoS-17/370, 13 December 2017, pp. 35-36, <https://eiopa.europa.eu/Publications/Reports/2017%20IORP%20Stress%20Test%20Report.pdf>

¹¹³ Substantial deficits occur in the Netherlands and the UK, comprising 90% of the defined benefit sector in Europe. Pension funds from all other Member States (except Cyprus) are sufficiently funded relative to their national funding requirement.

Member State's competence, as also taxation, and they are both important in EU cross border occupational pensions.

At the same time, ensuring compliance with national SLL may result in costs (for example, by retaining some local administration). SLL requirements may also have a prudential impact, making a cross-border activity a complex undertaking. For instance, national differences in governance requirements for minimum employee representation can make the administration of a cross-border IORP costly.

The challenge is thus to respect the different national SLL and the social protection mechanisms it gives in combination with a cross-border activity of an IORP. In other words, the social protection under SLL should not be weakened for those members participating in a cross-border IORP, but IORPs should be able to work in a cross-border context. As with the coordination rules in statutory pensions¹¹⁴, such a combination is often difficult to start with and requires a coherent and comprehensive approach without installing harmonisation of rules.

Similarly, difference between tax treatments of occupational pensions across Europe entails costs. Most Member States employ the so-called EET system (contributions exempt, investment returns exempt and benefits taxed) but other systems, like ETT, also exist. Fiscal coherence would require unanimous decisions at EU level and that is very difficult to achieve.

2.1.3. Challenges related to the portability of pension rights

Cross-border workers experience difficulties or find it impossible to take occupational pensions to another Member State.

The portability of occupational pensions may be beneficial for cross-border workers settling in another Member State¹¹⁵. Firstly, it avoids that cross-border workers have several pension rights of rather small value dispersed over several pension schemes (often referred to as “small pension pots”). Secondly, it ensures that the worker has a comprehensive overview of his or her pension entitlements.

However, according to the available data, cross-border transfers of supplementary pension rights are not very common¹¹⁶ and have to be carried out in accordance with different national rules. In about one third of Member States, pension scheme members have a statutory right to transfer their accrued pension rights to another EEA country. In most countries there are conditions attached to the right to transfer, most importantly related to the features of the receiving

¹¹⁴ Regulation (EC) No 883/2004 of the European Parliament and of the Council on the coordination of social security systems

¹¹⁵ According to the Eurobarometer survey, the share of the population that worked in more than one Member State during their career amounted to 13% in 2010.

¹¹⁶ EIOPA, [Final Report on Good Practices on individual transfers of occupational pension rights](https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-15-104_Final_Report_on_Pensions_Transferability.pdf), EIOPA-BoS-15/104, 2 July 2015, p. 13 and Annex II, https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-15-104_Final_Report_on_Pensions_Transferability.pdf

scheme.¹¹⁷ National legislators aim to ensure that accrued pensions – which governments have often supported through tax subsidies – continue to be used for retirement purposes as defined by national SLL¹¹⁸. The obvious challenge here is to combine the demand of the Member States to keep the existing social coherence on the basis of their national SLL with European portability. An arrangement has been made for this challenge for statutory pensions¹¹⁹ but is more complicated for supplementary schemes.

In response to a Call for Advice from the European Commission, EIOPA published a good practice report about how the transferability of supplementary pension rights works in practice. The report identified areas that discourage portability relating to, among other things, the requirements for transferring and receiving schemes, provision of information and advice to scheme members, costs and charges, the transfer process and the identification of (eligible) receiving schemes¹²⁰.

Although no harmonised EU rules ensuring portability of occupational pension rights exist, efforts have been made at EU level to improve portability. Thus, the Directive on the acquisition and preservation of supplementary pension rights¹²¹ establishes minimum standards for the protection of mobile workers' pension rights. It calls upon Member States to endeavour to improve the transferability of pension rights, as far as possible, and in particular when introducing new supplementary pension schemes¹²².

To support a lack of portability also by other means, the European Commission is supporting pension providers in implementing a European tracking service for pensions (ETS), which would provide mobile workers with insight in their overall pension situation.

European tracking service for pensions

To help mobile workers track their pension rights in different countries, the European Commission supports pension stakeholders in preparing a **European tracking service for pensions** (ETS). Once completed, the ETS would provide mobile workers with an overview of their pension rights held in different countries and schemes¹²³, by accessing information available from national tracking services and other already available resources. In 2018, the Commission awarded a grant to a consortium of pension stakeholders to implement the pilot

¹¹⁷ Eighteen Member States impose conditions on the type of receiving scheme to which transfers can be made according to the EIOPA report mentioned in the previous footnote.

¹¹⁸ See EIOPA, Final Report on Good Practices on individual transfers of occupational pension rights, EIOPA-BoS-15/104, 2 July 2015, https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-15-104_Final_Report_on_Pensions_Transferability.pdf

¹¹⁹ Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems, OJ L 166, 30.4.2004, p. 1, [EUR-Lex - 02004R0883-20140101 - EN - EUR-Lex](#)

¹²⁰ Final Report on Good Practices on individual transfers of occupational pension rights, cited above

¹²¹ Directive 2014/50/EU, cited above

¹²² Recital 24 of Directive 2014/50/EU, cited above.

¹²³ [Establishing an ETS. Recommendations for creating a European pension tracking service](#), TTYPE, 2015, <https://ec.europa.eu/social/BlobServlet?docId=16387&langId=en>.

phase of a European tracking service for pensions in 2019-2021. The project foresees to develop the ETS based on the portal www.findyourpension.eu, which already helps European mobile researchers find their pension providers in other Member States.

2.1.4. Challenges for members and beneficiaries

Members and beneficiaries need to receive clear, accurate and sufficiently comprehensive information on their accrued rights and schemes. They need to be able to trust that their pension system will provide them with adequate income after retirement.

Member and beneficiaries need to trust their occupational pension system and to be reassured as to the adequacy of their retirement income. Regulatory changes of the scheme or the pension system as a whole may contribute to enhancing the protection of members and beneficiaries but may also undermine the trust.

Providing beneficiaries with reliable, comprehensible and clear information is another key element for building up trust¹²⁴ (see chapter 1 and Chapter 2, section 2.2 for more details on the challenges of trusting in the pensions systems and information provision). The enhanced rules for providing information to members and beneficiaries in the IORP II Directive and part of EIOPA's work aim at addressing this issue.

Information on pension rights: the EU example

The **IORP II Directive** contains enhanced requirements on the provision of information during the pre-enrolment phase, the accumulation phase, the pre-retirement phase and the pay-out phase. This will be done through a concise and standardised document, the annual Pension Benefit Statement (PBS). The PBS includes information on pension benefit projections in a best estimate scenario and unfavourable scenario as well as a breakdown of the costs deducted in the past 12 months. In order to ensure uniform application, the Directive calls upon Member States to exchange best practices with regard to the format and content of the PBS. EIOPA published two reports with guidance and principles based on current practices for the PBS¹²⁵ and the other information documents¹²⁶.

¹²⁴ See also EIOPA, Report on the Pension Benefit Statement: guidance and principles based on current practices, 13 November 2018, <https://eiopa.europa.eu/Publications/Reports/EIOPA%20PBS%20guidance%20and%20principles.pdf>, and EIOPA, Report on other information to be provided to prospective and current members: guidance and principles based on current practices, 26 March 2019, <https://eiopa.europa.eu/Publications/Reports/EIOPA%20IORP%20II%20Other%20information%20for%20members%20good%20practices%20March%202019.pdf>.

¹²⁵ <https://eiopa.europa.eu/Pages/News/EIOPA-news-13-11-18.aspx>

¹²⁶ <https://eiopa.europa.eu/Pages/News/EIOPA-determines-principles-for-transparent-timely-and-clear-information-provision-on-pension.aspx>

2.1.5. Challenges related to the role of the social partners at EU level

While the role of social partners varies across the EU, there is no dedicated forum for exchange of experience and practices at EU level.

As described in Chapter 1, social partners can play a key role in the establishment and functioning of occupational pension schemes at Member State level. From a European perspective, Article 152 of the Treaty of the Functioning of the European Union (TFEU)¹²⁷ provides that the EU recognises and promotes the role of the social partners and facilitates the dialogue between them¹²⁸. Unfortunately, currently at EU level there is no forum where social partners and EU authorities could have a regular, structured exchange on pension related matters.

¹²⁷ Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47-390, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12012E%2FTXT>

¹²⁸ Article 152 TFEU: “The Union recognises and promotes the role of the social partners at its level, taking into account the diversity of national systems. It shall facilitate dialogue between the social partners, respecting their autonomy. ...”.

Recommendations to address the challenges identified in section 2.1

In view of the challenges outlined above, the High-level Group of Experts on Pensions **recommends that:**

The EU and Member States should:

- continue tackling the barriers to cross-border investment by pension providers, including the fiscal impediments, such as withholding tax.

The EU should:

- continue to follow the minimum harmonisation approach for regulation for IORPs, avoiding full harmonisation, giving Member States the necessary flexibility to supplement prudential requirements considering the national social, tax and labour law;
- carefully assess the results of the new rules put into place by the IORP II Directive and the Decision on cross-border collaboration before proposing any further change, other standardised EU products and/or horizontal regulatory framework;
- continue to support the development of a European tracking service for pensions to enhance transparency and trust in pension systems and enable citizens, including cross-border workers, to have a comprehensive and comparable overview of pension entitlements (including projections) in pension schemes across the EU in a cost-effective manner.

2.2. Challenges related to personal pensions

2.2.1. Background

Personal pension products are private pension savings which, like occupational pensions, are complementary to state-based public pensions. Depending on the architecture of national pension systems, they have different features, and serve different purposes and roles. However, personal pension providers, which are subject to EU rules, have to comply with harmonised prudential and conduct of business rules at European level¹²⁹, which aim at providing a high level of consumer protection.

While there is no universally agreed concept of personal pension, EU legislation defines personal pension products as financial products that are contracted on a voluntary basis and complementary to statutory or occupational pension products. They have an “explicit objective of providing income on retirement”, “providing for long-term capital accumulation”¹³⁰.

The diversity in product characteristics and their different roles in the national pension systems lead to differences in coverage across Europe. In general, coverage of personal pensions in the EU is on average low and uneven¹³¹ (see further details chapter 1 and section 2.2.2.1.)

In this context, the PEPP Regulation introduces for the first time a voluntary pan-European personal pension product with harmonised features and regulatory standards that will complement existing national products. The PEPP Regulation aims at addressing some of the challenges inherent to personal pensions described below and at promoting long-term investments throughout Europe. The future will show to what extent this goal is achieved.

2.2.2. Fragmented national markets

Personal pension markets are fragmented along national lines, resulting in a broad diversity difficult to embrace at an aggregated EU level.

The fragmentation of personal pension markets along national lines can be explained by the fact that the organisation of pension systems is primarily the competence of the Member States, ultimately leading to various set-ups in which personal pensions serve different purposes and roles. In most Member States, personal pension products tend to have a “top-up” function, complementing incomes from state-based (and sometimes occupational) pensions. However, some Member States have made a different choice, giving a more central role to personal

¹²⁹ There are some personal pension providers, which are not subject to EU rules.

¹³⁰ Article 2(1) PEPP Regulation.

¹³¹ 2018 Pension Adequacy Report 2018, p. 79.

pensions. Moreover, in Member States with less developed occupational pension systems, personal pensions tend to have higher take up¹³². Personal pensions can also be important for the self-employed in pension systems where they have no access to occupational pensions.

The design and characteristics of national personal pension products are determined at national level¹³³, e.g. conditions related to the accumulation¹³⁴ and decumulation¹³⁵ phases. Such characteristics usually also condition the eligibility for tax incentives and other advantages for personal pension products and reflect broader national policy agendas.

Nevertheless, EU rules, covering both prudential and conduct of business aspects, apply to the different types of personal pension providers which benefit from a passport for the EU internal market. For instance, the Solvency II Directive and IDD¹³⁶ for insurance undertakings, the UCITS Directive¹³⁷ and MiFID II¹³⁸ for asset managers, CRD IV¹³⁹ and MiFID II for credit institutions and the IORP II Directive in the Member States where IORPs operate in the retail market¹⁴⁰.

In practical terms, this means that providers operating in more than one market need to design personal pension products with different features as required at national level. This makes it difficult to provide personal pensions on an EU-wide scale and, in turn prevents providers from reaping the benefits that an EU single market would bring in terms of economies of scale. This fragmentation can also be a challenge for some individual savers as it creates a barrier to cross-border mobility. Last but not least, it is also a challenge for European regulators because the fragmentation of national pension systems makes it difficult to embrace the diversity of systems and practices at European level.

¹³² For example, in 2016, in the Czech Republic personal pension schemes have about 8,000,000 members. See [EIOPA's advice on the development of an EU Single Market for personal pension products \(PPP\), July 2016, p. 7, 83, https://eiopa.europa.eu/Publications/Consultations/EIOPA%27s%20advice%20on%20the%20development%20of%20an%20EU%20single%20market%20for%20personal%20pension%20products.pdf](https://eiopa.europa.eu/Publications/Consultations/EIOPA%27s%20advice%20on%20the%20development%20of%20an%20EU%20single%20market%20for%20personal%20pension%20products.pdf)

¹³³ According to EIOPA data, a quarter of the personal pension products surveyed in 2016 was regulated exclusively by national law (EIOPA's advice cited above, p. 82)

¹³⁴ Such as ages limits, minimum duration of investment, maximum and minimum in-payments.

¹³⁵ Such as retirement age, conditions for early redemption and forms of out-payment.

¹³⁶ Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast), OJ L 26, 2.2.2016, p. 19, <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32016L0097>

¹³⁷ Directive 2009/95/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (recast), OJ L 302, 17.11.2009, p. 32, <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32009L0065>

¹³⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directives 2002/92/EC and Directive 2011/61/EU (recast), OJ L 173, 12.6.2014, p. 349, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065>

¹³⁹ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, p- 338, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013L0036>

¹⁴⁰ According to EIOPA data, almost half of the personal pension products surveyed in 2016, representing 83% of assets under management, are distributed by providers falling under the Solvency II Directive (EIOPA's advice on PPP, cited above p. 82).

2.2.3. Portability and taxation issues

Portability of personal pension rights from one Member State to another is often limited.

Portability of personal pensions is desirable for European citizens working and living in multiple Member States. It can prevent the dispersion of personal pensions over several small pots throughout the EU and help savers to have a comprehensive overview of their pension savings.

The potential demand for portable personal pension products in Europe is, for the time being, limited, with only 3.4% of the working population working outside their own country¹⁴¹. This makes it difficult for providers offering portable products to achieve critical mass, economies of scale and ultimately cost-efficiency. However, the figure of people living outside their own country has doubled over the past decade. In addition, the share of the population that has worked in more than one Member State during their career amounted to 13% in 2010¹⁴², and the share of mobile workers varies from one country to another depending on various factors (size, unemployment rates, etc.). Therefore, the demand for portable products is not uniform throughout the EU.

Portability of personal pensions can be defined in two different theoretical forms:

1. the possibility for savers, after changing their residence to another Member State, to continue contributing to the same pension product with the same pension provider without any cross-border transfers of assets taking place while being able to benefit from tax relief and other advantages offered in the new Member State of residence;
2. the possibility for savers, after changing residence to another Member State, to transfer their personal pension savings to the same or to a different provider in another Member State (i.e. cross-border switching of providers) in order to benefit from tax relief and other advantages offered in the new Member State of residence. Savers may transfer their assets during the accumulation phase when moving abroad. Alternatively, they may find it in their best interest to transfer their assets and consolidate their pension pots only when starting the decumulation phase.

Each of these two forms of portability raise specific challenges:

The first form of portability (the possibility for savers to continue saving in the same product with the same provider) implies that providers are able to design a flexible personal pension product that embraces/can be adapted to all features required at national level to benefit from fiscal relief or other incentives. Considering the diversity of personal pension markets across the

¹⁴¹ European Commission, *EC Communication - The Single Market in a changing world A unique asset in need of renewed political commitment*, according to which in 2017, 17 million EU citizens were living or working in another MS, 9.5 million of which were “economically active”, <https://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-772-F1-EN-MAIN-PART-1.PDF>. In 2017, 17 million EU citizens were living or working in another MS, 9.5 million of which were “economically active”.

¹⁴² Eurobarometer survey from 2010.

EU, this is very challenging, as a single provider would need to be able to deal with the specific languages and national legal requirements in the different Member States (in particular, taxation regimes, contract law, etc.).

Looking at the second form of portability (which in practice constitutes a cross-border transfer of personal pension savings), there are many obstacles to such transfers, including outright bans of transfers in some Member States¹⁴³. Even when allowed by national law, cross-border transfers of personal pension savings are rarely attractive to savers because of the complexity and the costs of the process. In addition, when the transfer is made to a different provider (i.e. cross-border switching), there may be further limitations and/or prohibitive exit fees (see section 2.2.2.3).

Difficulties with cross-border transfers – bans, prohibitive fees or other limitations - national and EU examples

The results of a 2016 EIOPA survey on cross-border requirements for personal pensions¹⁴⁴ showed different obstacles to such transfers. For example, in some Member States (i.e. **Bulgaria, Poland**) cross-border transfers of personal pension products are not allowed since this situation is not regulated by EU and national legislation. In other Member States, nationally recognised personal pension products (non-insurance based) cannot be transferred due to restrictions on cross-border scheme management (**Czech Republic, Croatia and Lithuania**) or because of taxation and scheme management obstacles (**Spain**). In a third group of Member States, transfers are not forbidden in general but are not possible in practice because of different reasons. In **Luxembourg**, the insurance secrecy rules could be an obstacle if a contract was to be transferred from Luxembourg to another country¹⁴⁵. In the **UK**, benefits may be transferred into a UK pension scheme from any foreign scheme; but a registered pension scheme may only make a transfer into a foreign pension scheme that is approved for the purpose by HMRC¹⁴⁶. A transfer to a foreign scheme which is not approved, or which has lost its status will be an unauthorised payment with associated tax charges (40%). In **Ireland** transfers are allowed, but for certain products only under certain conditions.

In the EU, under the PEPP Regulation, mobile savers will benefit from a portability service allowing them, under certain conditions, to continue contributing to the same PEPP when changing residence between Member States¹⁴⁷.

¹⁴³ See EIOPA, Towards an EU single market for personal pension: An EIOPA Preliminary Report to COM, 2014, pp. 28-38; EIOPA's advice on PPP, cited above, p. 57-61.

¹⁴⁴ Ibid., pp. 96-97 on the results related to the question on barriers to cross-border PPP transfers.

¹⁴⁵ If savers agree to give up on the insurance secrecy privilege, there would be no obstacle to transfers.

¹⁴⁶ The UK tax collection office – Her Majesty's Revenue and Customs (HMRC).

¹⁴⁷ See Articles 17 to 21 of the PEPP Regulation.

One of the most significant difficulties in cross-border transfers of pension savings is related to **taxation**. Tax treatment of personal pensions is very different across the EU and is often linked to the specific characteristics of eligible personal pension products. However, the Court of Justice ruled that Member States cannot allow domestic tax free transfers of pension capital and at the same time tax cross-border transfers¹⁴⁸. Where a Member State allows domestic transfers, but prohibits or restricts cross-border transfers, it is likely that this infringes the free movement of workers, the freedom to provide services and the free movement of capital. Furthermore, granting a tax reduction solely where deposits and payments are made to institutions established in the Member State concerned constitutes a restriction on and a breach of the free movement of capital since savers will be deterred from transferring sums in connection to institutions in another Member State.

The differences in national tax treatment can also lead to double taxation of personal pensions when accumulated capital is transferred from a Member State where contributions are taxed to a Member State where benefits are taxed. Since direct taxation is the exclusive competence of individual Member States, the prevention of double taxation (and potentially non-taxation) depends of the willingness/capacity of Member States to adopt corresponding domestic rules or to adjust their bilateral tax treaties.

The challenge is thus to establish a form of portability in a proper, elaborated, well-adjusted and balanced manner without jeopardizing the clear wish of the Member States to prevent tax avoidance.

2.2.4. Switching and long-term investments

The possibility for savers to switch providers/products is often limited or discouraged by exit fees, which can affect the take-up of personal pension products and the emergence of a more competitive market. The challenge is to strike the right balance between the need to provide savers with sufficient switching flexibility while enabling providers to make long-term investments and to provide adequate guarantees.

Currently, switching practices are different across the EU. In some cases, switching is available within a short period of time. In other cases, switching provider before the end of a fixed holding period is disincentivised by means of penalising exit fees¹⁴⁹.

The insufficient flexibility for savers to switch between products and providers may constitute a major disincentive to take-up personal pension products (so called “lock-in” effect). The possibility to switch is a key driver for consumer trust, as it significantly lowers the

¹⁴⁸ Judgment of the Court of Justice of 5 July 2007, *Commission v Belgium*, Case C-522/04, ECLI:EU:C:2007:405; see also judgment of the Court of Justice of 28 January 1992, *Bachmann v Belgium*, Case C-204/90, ECLI:EU:C:1992:35; judgment of the Court of Justice of 11 August 1995, *Wielockx*, Case C-80/94, ECLI:EU:C:1995:271; judgment of the Court of Justice of 28 April 1999, *Safir*, Case C-118/96, ECLI:EU:C:1998:170; judgment of the Court of Justice of 30 January 2007, *Commission v Denmark*, Case C-150/04, ECLI:EU:C:2007:69; judgment of the Court of Justice of 23 January 2014, *Commission v Belgium*, Case C-296/12, ECLI:EU:C:2014:24.

¹⁴⁹ See [European Commission, 2017 PEPP impact assessment](https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-343_en), p. 16, https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-343_en

psychological hurdle to buying a product for the very long term. It also stimulates competition amongst providers, and allows for product improvements¹⁵⁰. Finally, switching providers may be necessary for mobile savers (i.e. cross-border switching), when they move residence to another Member State (see section 2.2.2.2.).

On the other hand, and in line with the idea of long-term saving, personal pension products should contribute to the funding of long-term illiquid investments, like infrastructure, real estate and private equity for SMEs, with the potential to earn an illiquidity premium over a long-term period. Investments in such asset categories could be more difficult if consumers were able to switch freely and at any time between providers, potentially reducing the return savers receive on personal pension products. Frequent switching also makes it more difficult to provide adequate long-term guarantees.

Switching and long-term investments: the EU example

Under the PEPP Regulation, savers are entitled to switch providers every five years during the accumulation and, under certain conditions¹⁵¹, during the decumulation phase. The total fees and charges are limited to the actual administrative costs incurred by the provider but should not exceed 0.5% of the asset value. However, savers will be able to switch without delay and free of charge when no sub-account is available for the Member State to which the saver moves. These provisions aim to strike the right balance between providing savers with sufficient switching flexibility and enabling providers to make long-term investments and to provide adequate guarantees.

2.2.5. Information requirements

The quality of information provided to savers can be sub-optimal. The variety of disclosure requirements is a challenge for providers operating cross-border, as they need to comply with different or duplicative rules. The insufficient availability, quality and comparability of data makes it also difficult for regulators to get a comprehensive view at EU level.

Personal pension products are generally taken out on an individual and voluntary basis, leaving it up to individuals to take active steps to prepare for retirement. This means that consumers interact directly with providers/distributors on a retail basis. Unlike in occupational pensions, the employer or social partners are typically not involved in this process. Savers bear the costs and quite often also the risks¹⁵² attached to a particular personal pension product. Choosing such a

¹⁵⁰ EIOPA's advice on PPP, cited above, p. 51

¹⁵¹ See Article 52 of the PEPP Regulation.

¹⁵² Savers bear the risks of the product to various extents depending on the (minimum) guarantees entailed by the product.

product can be an important financial decision in one's life. It involves the need to compare and assess the suitability, the key features of different products on the market (like biometric risk coverage, guarantees, consequences of interrupted contributions), as well as the expected benefits, the costs and the risks involved. This process is challenging given the average low levels of financial literacy¹⁵³ and the various behavioural biases that can affect the taking of rational long-term decisions. Against this background, the quality of the information received is even more important for personal pension savings than for occupational pensions.

Information disclosure: the EU example

Under the PEPP Regulation providers shall make available to savers, during the life of the contract, an annual Pension Benefit Statement (PBS). The PBS shall contain key information in a standardised format, taking into account the specific nature of the national pension system. It shall contain, *inter alia*, the earliest date on which decumulation may start, information on past performance, in order to enable the savers to compare the performance of their PEPP during the life of the product, breakdown of costs, the nature and the mechanism of the guarantee or the risk mitigation technique, the total amount in the PEPP account as of the date of the statements. .

There is currently no harmonised EU information disclosure framework dedicated to personal pension products. Information provision is often determined by national and sectorial rules, which vary across Member States to reflect the different roles and definition of personal pensions set at national level and also depend on the type of provider. In addition, certain sectoral EU rules may also apply (i.e. PRIIPs Regulation,¹⁵⁴ IDD, Solvency II Directive, Distance Marketing Directive for Financial Services¹⁵⁵ (DMD), e-commerce Directive)¹⁵⁶.

Information disclosure: the national example

For example, Member States like Austria, Belgium, the Netherlands and Germany, have extended the scope of the Key Information Document (KID) of the PRIIPs Regulation.

¹⁵³ OECD, *Financial education in Europe. Trends and recent developments*, April 2016, <https://www.oecd.org/education/financial-education-in-europe-9789264254855-en.htm/>

¹⁵⁴ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), OJ L 352, 9.12.2014, p. 1–23, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R1286>

¹⁵⁵ Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, OJ L 271, 9.10.2002, p. 16–24,

¹⁵⁶ Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce'), OJ L 178, 17.7.2000, p. 1–16, <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32000L0031>.

Furthermore, even for products with the same disclosure requirements, the presentation of information is not always standardised which deprives disclosure requirements of their intended purpose – to enable savers¹⁵⁷ to compare products and take a rational decision.

The current diversity of regimes applicable to personal pensions may be a challenge for providers offering various types of products or offering products on various markets, as in such cases they are required to implement different or duplicative rules.

This variety of regimes may also become a challenge for savers in cases where they wish to compare products on cross-border basis or national products subject to different disclosure rules. They may be confronted with duplicative or not comparable information or with information gaps, making it harder for them to take informed pension decisions. In addition, the lack of standardisation (of the presentation) of information disclosed (in particular for costs), even for products with similar disclosure requirements, makes comparison of products very challenging if not impossible, preventing savers from taking an enlightened decision.

Furthermore, comparability of costs, especially for products with similar characteristics, is particularly important to enhance competition. If not well informed, in particular in view of the complexity and opacity of information on costs in certain cases, savers may end-up paying too much for their personal pension product because they are not able to easily compare products and identify the one that offers them best value for money. As a consequence, providers may lack sufficient incentives to lower costs and offer competitive products, which may translate in globally more expensive products. This issue has been highlighted by Better Finance in its 2018 report on “Pension Savings – the real return” which concluded that “charges are often complex, opaque and far from being harmonized between different pension providers and products”.¹⁵⁸

Finally, the lack of an EU personal pension disclosure framework makes it difficult for regulators to have a comprehensive picture at an aggregated EU level. Comparing personal pension products across countries can be challenging, as the data included in the national disclosure documents is not comprehensive enough to enable comparisons of costs and performance across Member States, due to diverse rules and the lack of detailed and shared methodologies for information on costs and performance. For instance, in its recent report on costs and past performance of retail investment and pension products¹⁵⁹, EIOPA has refrained from drawing conclusions on personal pension products because of limitations to the sample in terms of market coverage, due to issues with availability, quality and comparability of data.

Information overload and duplication: EU example

The cumulative impact of individual European, national or sectoral rules and the coherence of

¹⁵⁷ Or at least those savers willing to compare products.

¹⁵⁸ Pension savings – the real return, cited above.

¹⁵⁹ [EIOPA Report on Costs and Past Performance of insurance and pension products, January 2019, https://eiopa.europa.eu/Pages/News/EIOPA-analyses-costs-and-past-performance-of-insurance-and-pension-products.aspx](https://eiopa.europa.eu/Pages/News/EIOPA-analyses-costs-and-past-performance-of-insurance-and-pension-products.aspx)

the entire regulatory framework can result in information overload for savers and sometimes duplication between different pieces of legislation applicable to the products, their providers and distributors. This may, in certain cases, lead to consumers not being able to choose or select the features which best meet their needs.

For instance, with the introduction of the PEPP KID, for a PEPP, the combined effect of pre-contractual disclosure requirements under PEPP, Solvency II, IDD, GDPR¹⁶⁰, the e-Commerce Directive, the Distance Marketing Directive (DMD) and the Regulation on the sustainability-related disclosures¹⁶¹, could result in an insurance broker who sells a PEPP online having to make between 158 and 202 information disclosures at pre-contractual stage¹⁶².

2.2.6. Distribution and advice

The provision of personal pension products is subject to different distribution regimes setting different standards. This is burdensome for providers/distributors but leads also to uneven standards of advice for consumers when buying personal pension products. In addition, evidence gathered before the application of the IDD showed that it can be a challenge for consumers to obtain advice in their best interest, due to conflicts of interest of advisors.

High-quality information provision in itself may not be sufficient to ensure that consumers purchase appropriate personal pension products fitting their circumstances and needs. Even if the information received is clear, concise and understandable, consumers may still not be able to choose the best suited pension product. This is where distribution regimes with conduct-of-business standards come into play - to assist consumers in choosing the right personal pension products and to avoid mis-selling.

Personal pension products can be distributed by the providers, their agents and third-party intermediaries. In most Member States, the majority of personal pension products is sold directly either through the provider or by the group of the provider. The share of internet distribution is still very low¹⁶³.

Like information requirements, the provision of personal pension products is to a large extent subject to national distribution rules. EU legislation provides only a limited set of rules and

¹⁶⁰ Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (Text with EEA relevance) *OJ L 119, 4.5.2016, p. 1–88*, <https://eur-lex.europa.eu/eli/reg/2016/679/oj>

¹⁶¹ Regulation (EU) 2019/2088 of the European Parliament and the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, *JO L 317, 09.12.2019, p. 1*, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN>

¹⁶² [Insurance Europe PEPP key messages](https://www.insuranceurope.eu/sites/default/files/attachments/PEPP%20key%20messages%20-%20Information.pdf) (figures above were updated based on the final PEPP Regulation. The final number of PEPP pre-contractual disclosures will depend on the interpretation of article 3 of the PEPP Regulation and the outcome of Level II technical standards), <https://www.insuranceurope.eu/sites/default/files/attachments/PEPP%20key%20messages%20-%20Information.pdf>

¹⁶³ See EIOPA's advice on PPP, cited above, p. 86-87.

principles on the distribution of personal pension products. This includes, for example, the general distribution rules for insurance products set out in the IDD. However, most personal pension products are explicitly excluded from the scope of the more specific distribution rules for investment products (such as the IDD chapter on the distribution of insurance-based investment products and MiFID II)¹⁶⁴. This is due to the high diversity of personal pension systems and the different traditions, policy approaches and market realities in the Member States (see above section 2.2.2). The applicable national distribution rules may not always afford the same level of protection as the distribution requirements in the IDD chapter on insurance-based investment products¹⁶⁵ and MiFID II which provide rules on procedures and arrangements to avoid conflicts of interest harming the consumer as well as additional disclosure and transparency rules.

This can be a challenge for providers/distributors proposing various types of products or doing business in various markets because they would have to abide by multiple sets of distribution rules within and between Member States.

For consumers, it can be challenging to obtain high-quality and neutral advice in their best interest. Evidence gathered before the application of the IDD shows that consumers seeking advice from sellers receiving sales commissions and other forms of inducements, such as banks and many insurance distributors,¹⁶⁶ were often not offered the most suitable and cost-efficient products, as given their remuneration model, advisors were incentivized to recommend those products that offer them the most generous commissions, and not those that were in their customers' best interest. The results of a mystery shopping exercise conducted before the application of the IDD in the context of a Study on retail investment¹⁶⁷, commissioned by the European Commission, confirms the often reported bias of such advisors, due to their remuneration model. For instance, investment products carrying low fees, were rarely proposed by advisors who instead tended to suggest more expensive products from a limited portfolio of preselected products. Also consumer associations routinely point out that financial advice offered to savers is often not geared towards the savers' best interest, but driven by sales commissions, aimed at extracting maximum profit from consumers.

Distribution and investment advice on personal pension product: the EU example

The distribution rules in the **PEPP Regulation** follows a sectoral approach. PEPP providers and distributors are subject to the sectoral distribution rules in the IDD or MiFID II, including the requirements for (insurance-based) investment products. As such, PEPP providers and distributors are subject to more stringent rules regarding suitability and conflicts of interest, especially where they pay or are paid fees and commissions. Providers and distributors are

¹⁶⁴ See PEPP impact assessment, cited above, p. 22.

¹⁶⁵ Articles 26 to 30 of IDD.

¹⁶⁶ Which remains the norm for the average European investor.

¹⁶⁷ Study on the "Distribution systems of retail investment products across the European Union", 2018, https://ec.europa.eu/info/sites/info/files/180425-retail-investment-products-distribution-systems_en.pdf

required to give advice to a prospective saver by means of a personalised recommendation. The PEPP Regulation also facilitates electronic distribution and automated or semi-automated advice.

2.2.7. Regulatory frameworks

Personal pension products are currently predominantly provided by insurers subject to the EU prudential framework of the Solvency II Directive. It has proved to be a challenge to find appropriate methodologies and calibrations for the Solvency II Directive that both ensure the adequate protection of consumers and adequately capture the long-term nature and interaction between assets and liabilities.

Prudential rules aim to ensure that providers of personal pensions fulfil their promises to customers. This is of particular importance in the pension area, where commitments are by definition long-term, and citizens can be dependent on their personal pension product for adequate retirement income.

Personal pensions can be provided by different financial institutions, each subject to its own sectoral prudential framework reflecting the type of financial products provided. Prudential rules set high minimum standards for governance, risk management, disclosure and capital requirements, depending on the risks borne by the provider. Clearly for products with guarantees, capital requirements will be of much greater relevance than for products, where the customer bears all investment risks.

Insurers cover 83% of the personal pensions market in terms of assets under management, and can underwrite biometric and financial guarantees¹⁶⁸. Solvency II, the EU prudential framework applicable to insurers, is widely regarded as a comprehensive and sophisticated risk-based framework. However, there have been discussions and concerns about the treatment of long-term guarantees in the framework, including guarantees relating to personal pensions.

The valuation of insurance liabilities and the measurement of capital requirements need to ensure the protection of consumers by capturing the level of risks entailed by the long-term liabilities. Developing appropriate methodologies has in recent years been at the centre of policy discussion and has proved to be a challenge.

Too low capital requirements can in fact be as damaging for savers as too high capital requirements. On the one hand, having too low capital requirements to back up liabilities reduces the level of safety pension savers are rightly entitled to. On the other hand, having too high capital requirements can make pension products prohibitively expensive, reducing the demand and provision of product designs that savers are interested in (e.g. long-term savings with guarantees).

¹⁶⁸ [EIOPA's advice on PPP](#), cited above, p. 84:

Recommendations to address the challenges identified in section 2.2

In view of the challenges outlined above, the High-level Group of Experts on Pensions **recommends that:**

The EU and Member States should:

- include in personal pensions fair early exit options for cases of personal hardship;
- ensure that personal pension providers report annually on the net performance of their respective retirement savings products;
- facilitate digital distribution in order to increase access to private pension savings, while ensuring strong consumer protection;
- ensure that consumer information enables savers to make a meaningful assessment of different types of products (including their specific protection features).

The EU should:

- as regards pensions activity of insurers, when reviewing Solvency II in 2020, revise the regulatory framework, so as to ensure that this framework does not include undue barriers to long-term investment, is fit for purpose and reflects the real risks of long-term pension liabilities, and that pension promises can be met;
- ensure that consumer information is clear, not misleading and fit for purpose (e.g. highlighting the benefits of protection offered and/or possible losses);
- remove information overload and duplications resulting from the cumulative application of EU legislation, in line with the REFIT Platform recommendations.

Recommendation to address the challenges identified in sections 2.1. and 2.2

Furthermore, the High-level Group of Experts on Pensions **recommends that:**

The EU and Member States should:

- ensure that the legislation applicable to pensions is digitally and environmentally friendly and technologically neutral, while keeping the option of paper disclosure free of charge.

Supplementary pensions and the EU sustainable finance goals

3.1. Background

Increasing focus on climate change led to the signature of the Paris Agreement in 2015, where all nations promised to “undertake ambitious efforts to combat climate change and adapt to its effects”¹⁶⁹. In a broader context, the United Nations adopted the 2030 Agenda for Sustainable Development¹⁷⁰ which aims at eradicating “poverty in all its forms and dimensions”, and contains 17 Sustainable Development Goals (SDGs) including Climate Action. The EU also has the ambition to move towards sustainable development and become the global leader in the fight against climate change¹⁷¹.

The EU recognises that the financial sector, including pension providers, have a key role to play in reaching its environmental and social goals to ensure sustainable economic growth. It has therefore undertaken a number of initiatives in the area of sustainable finance, including the setting up of a High-Level Expert Group on sustainable finance, the adoption of the Action Plan on Financing Sustainable Growth¹⁷² in March 2018 and the three legislative proposals which are part of this plan¹⁷³.

EU legislation on sustainable finance

In May 2018, the Commission proposed a package of legislative measures including a Regulation on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation), a Regulation on disclosure relating to sustainable investment and sustainability risks (Disclosure Regulation) and an amended Benchmark Regulation. The Disclosure Regulation¹⁷⁴ has been adopted by the European Parliament and the Council in 2019 and will become applicable as of 10 March 2021.

In addition, the Commission set up a Technical Expert Group on sustainable finance (TEG) to assist it in the development of a unified taxonomy for sustainable economic activities (see below).

¹⁶⁹ See Paris Agreement: essential elements at <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>

¹⁷⁰ Transforming our world: the 2030 Agenda for Sustainable Development, <https://sustainabledevelopment.un.org/post2015/transformingourworld>

¹⁷¹ See President Juncker’s State of the Union Address of 2017, https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_17_3165

¹⁷² Communication for the Commission, Action Plan: Financing Sustainable Growth, 8 March 2018, https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

¹⁷³ Commission’s legislative proposals on sustainable finance, 24 May 2018, https://ec.europa.eu/info/publications/180524-proposal-sustainable-finance_en

¹⁷⁴ Cited above

Furthermore, EU legislation (the IORP II Directive) has introduced for the first time provisions on the integration of so-called ESG factors in the investment policy and risk management of occupational pension funds. “E” stands for **Environmental** factors relating to the quality and functioning of the natural environment and natural systems; “S” stands for **Social** factors relating to the rights, well-being and interests of people and communities; and “G” stands for **Governance** factors relating to the good governance of companies and other investee entities¹⁷⁵. The amended Shareholders Rights Directive recognises that stewardship and long-term shareholder engagement of institutional investors – including pension providers – is an important lever to improve ESG performance of companies¹⁷⁶.

Sustainable finance seeks to encourage all financial sectors to become more environmentally and socially responsible, and to improve governance. However, some issues are particularly relevant for the provision of supplementary pensions. This chapter focusses specifically on those issues.

3.2. Reorienting capital flows towards a sustainable economy

Pension savings can make a key contribution in providing capital required to close the financing gap for sustainable economic development.

As set out in the Commission Action Plan on Financing Sustainable Growth, current allocations of capital and levels of investment are insufficient to support an environmentally and socially sustainable economic system. The European Commission reckons that based on estimates of the European Investment Bank (EIB), additional investments of at least €270 bn each year are required in the area of transport, energy and resource management infrastructure alone¹⁷⁷.

Pension providers are a major source of finance for the European economy, channelling pension savings to capital expenditure. Total pension assets of European providers amounted to roughly €8,000 bn at the end of 2014¹⁷⁸, of which 48% are managed by insurers, 36% by IORPs, 5% by pension funds not subject to the IORP Directive and the remaining 11% by other providers, like banks and asset managers.¹⁷⁹ In consequence, supplementary pensions have the potential to contribute to close the gap for the transition to a sustainable economy, while fulfilling their primary goal of delivering adequate pensions to members and beneficiaries.

¹⁷⁵ PRI Reporting Framework, Main definitions 2019, PRI Association, p. 3, <https://www.unpri.org/download?ac=1453>

¹⁷⁶ See Directive (EU) 2017/828 of the European Parliament and the Council 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32017L0828>. The Directive introduced requirements for institutional investors to publically disclose their shareholder engagement policy and its implementation.

¹⁷⁷ See European Commission, Action Plan: Financing Sustainable Growth, 8 March 2018, <https://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-97-F1-EN-MAIN-PART-1.PDF> and EIB, Restoring EU competitiveness, 2016, https://www.eib.org/attachments/efs/restoring_eu_competitiveness_en.pdf.

¹⁷⁸ Around €7,000 bn when excluding the non-EEA countries Israel and Switzerland.

¹⁷⁹ See FSB RCG-E, Report on European Private Pension Schemes: functioning, vulnerabilities and future challenges, Working Group on Private Pension Schemes Resilience: <http://www.fsb.org/2017/10/report-on-european-private-pension-schemes-functioning-vulnerabilities-and-future-challenges/>

3.3. Definitions and classification

The lack of clear definitions and classification on ESG for assessing the degree of sustainability of investments (taxonomy) hampers the successful re-directing of capital to sustainable development.

In order to increase sustainable investment, pension providers would benefit from a commonly agreed taxonomy. Without such a taxonomy, investors lack guidance enabling them to invest in sustainable assets with confidence, even when there is an interest to do so. The lack of clear, robust and comprehensive taxonomy has a comparatively larger impact on long-term pension providers because they operate under the assumption of legal certainty and consistency over time to fulfil their long-term liabilities.

The central advantage of a taxonomy for pension providers lies in the clarification that assets marketed as ESG are in fact ESG. A taxonomy would assist pension providers in understanding the degree of sustainability of financial market products and in designing ESG investment policies. It could also provide a consistent starting point for EU standards and labels for environmentally and socially sustainable products (see section 3.7). In addition, the taxonomy could support pension providers in their engagement with companies around their business models and transition plans¹⁸⁰.

Yet developing an objective taxonomy is a challenging task due to the lack of a common understanding of what is sustainable and what not. Regarding environmental sustainability, nuclear power plants, for instance, are closed down in some Member States but not in others, due to different perceptions of how sustainable they are as a source of energy. This is why, as part of its Action Plan on Financing Sustainable Growth, the EU Commission has started work on a common taxonomy for sustainable investment at EU level which will provide the necessary certainty for investors and allow pension providers to better understand their exposure to environmentally and socially sustainable economic activities¹⁸¹.

Definitions and classification

The Technical Expert Group on sustainable finance (TEG) began its work in July 2018 and on 18 June 2019 published three important reports: one [on EU Taxonomy](#)¹⁸², one [on EU Green Bond Standard](#)¹⁸³ and one on [EU Climate benchmarks and benchmarks' ESG disclosures](#)¹⁸⁴. These reports

¹⁸⁰ See for an overview of the potential uses of an EU taxonomy for sustainable activities EU HLEG on Sustainable Finance, Financing a sustainable European economy, Final Report, 31 January 2018, p. 16, https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

¹⁸¹ See Commission Proposal for a Regulation on the establishment of a framework to facilitate sustainable investment, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0353>. See also the work of the EU Technical Expert Group on Sustainable Finance, https://ec.europa.eu/info/publications/sustainable-finance-technical-expert-group_en.

¹⁸² https://ec.europa.eu/info/publications/sustainable-finance-teg-taxonomy_en#190618

¹⁸³ https://ec.europa.eu/info/publications/sustainable-finance-teg-green-bond-standard_en#190618

¹⁸⁴ https://ec.europa.eu/info/publications/sustainable-finance-teg-green-bond-standard_en#190618

include key recommendations on the types of economic activities that can make a real contribution to climate change mitigation or adaptation.

Furthermore, in June 2019, the Commission also published new [guidelines](#)¹⁸⁵ on corporate climate-related information reporting.

Regarding social sustainability, the discussion on the taxonomy has yet to start at the EU level. An additional challenge is the treatment of government bonds in the taxonomy and as ESG investments.

3.4. ESG investments and fiduciary duty

The lack of clarity about the interpretation of fiduciary duty may discourage supplementary pension providers from considering ESG factors in investment decisions.

Supplementary pension providers have a fiduciary duty vis-à-vis members and beneficiaries, meaning that providers have the legal obligation to manage their assets in the best long-term interests of the members and beneficiaries¹⁸⁶.

Under a traditional interpretation, the fiduciary duty requires pension providers to focus exclusively on maximising risk-adjusted financial returns, leaving no room for the integration of non-financial factors in investment decisions. Increasingly there is the view that the consideration of ESG factors enhances risk-adjusted returns and therefore is possible or even required by the prudent person rule.

Fiduciary duty: the UK example

In **the UK** the framework for responsible investments and the understanding of fiduciary duty in that respect, has been influenced heavily by case law. Traditionally, case-law held that fiduciary acting in the best interest of the member meant solely best financial interest. Thinking subsequently evolved to argue that ESG factors can be financially material and therefore compliant with the fiduciary duty.

Case law was supplemented by further guidance and regulation. Since 2000 pension funds in the UK are required to disclose their policy on ESG issues as part of their statement of investment principles. In 2010 the Financial Reporting Council released the UK Stewardship Code, setting out principles for disclosure, monitoring of investee companies, voting policies, etc. Institutional investors are expected to follow this principle.

¹⁸⁵ European Commission, *Guidelines on reporting climate-related information*, 2019, https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdfhttps://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf.

¹⁸⁶ See Article 19(1)(a) IORP II Directive.

In response of these developments, on 1 October 2019 a new regulation came into force, requiring pension funds to update or prepare their statement of investment policy which should describe how they consider financially material factors such as ESG factors, including climate change.

European law reflects a broader approach to fiduciary duty. Thus, the IORP II Directive explicitly clarifies that “within the prudent person rule” IORPs are allowed “to take into account the potential long-term impact of investment decisions on environmental, social and governance factors”¹⁸⁷. The Directive also obliges IORPs to cover ESG risks relating to the investment portfolio in their risk-management system¹⁸⁸. The EU PEPP Regulation goes one step further by requiring PEPP providers to both take into account risk related to as well as the potential long-term impact of investment decisions on ESG factors¹⁸⁹.

However the clarification of fiduciary duty with respect to the integration of ESG factors and ESG risks in investment decisions currently applies only to IORPs subject to the IORP II Directive and does not address pension providers subject to other sectoral EU legislation. Moreover, the provisions may be interpreted and explained differently by different competent authorities in different Member States¹⁹⁰. Also, the practical application of the clarification may give rise to further questions by pension providers.

3.5. ESG related costs

Expected additional costs may be a practical impediment to integrate ESG factors in investment decisions. However, such costs may decrease over time and may be compensated by higher risk-adjusted investment returns.

Supplementary pension providers will experience one-off start-up costs to build up their capacity and expertise in integrating ESG factors in investment decisions and risk-management processes, but may also incur additional expenses on a more regular basis. Pension providers will often rely - either directly or indirectly - on external service providers, like asset managers, investment consultants, index providers, specialist ESG research and data vendors and proxy voting firms. The extra costs of their ‘ESG services’ are likely to decrease over time with the market growing due to the mainstreaming of ESG investing. However, it is yet unclear to what extent the higher costs will drop and at which point of time this will happen.

¹⁸⁷ Article 19(1)(b) IORP II Directive.

¹⁸⁸ Article 25(2)(g) IORP II Directive.

¹⁸⁹ See, for example, Articles 128(3)(c)(iii), 35(6)(c), 136(1) PEPP Regulation.

¹⁹⁰ For example, Member States have embedded the prudent person rule for IORPs in different ways in national legislation. This also contributed to different approaches to the supervision of the prudent person rule, like a risk-based approach or compliance-based approach using quantitative investment limits. See EIOPA, Results of the peer review on supervisory practices with respect to the application of the prudent person rule for IORPs, 15 April 2019, <https://eiopa.europa.eu/Pages/News/EIOPA-identifies-areas-for-improvement-in-the-supervision-of-Prudent-Person-Rule-compliance-by-institutions-for-occupational.aspx>

Higher costs may be a reason for pension providers to be reluctant about integrating ESG factors into their investment decisions¹⁹¹. This is especially the case for smaller pension providers, such as small- and medium-sized company pension funds, for which the costs are proportionately higher. Higher costs for providers will - at least in part - be passed on to members or savers, although they may be recouped through better investment outcomes. As such, the extent to which the extra costs are considered to be a hurdle also depends on whether pension savers and beneficiaries agree with the integration of ESG factors in the investment decisions, even though this may result in higher costs.

3.6. Environmentally sustainable investments and regulatory frameworks

Incentivising environmentally sustainable investments through the prudential framework in place (“green factors”) may undermine the risk-based nature of the framework and result in “green bubbles”, thereby jeopardising consumer protection. On the other hand, unjustified dis-incentivising of long-term investments may result in a lack of investment in sustainable activities.

Prudential frameworks serve the purpose of ensuring that pension providers are in a position to fulfil their duties towards beneficiaries and insurance policy-holders. Recently there have been discussions around amending prudential frameworks to incentivise investment in assets considered “sustainable” through “green factors”. However, the concern has been expressed that such a move could result in undermining the risk-based nature of the prudential frameworks in place. This would be the case if the “green factors” associated to certain assets would not correspond to the real risks of these assets. There is also the fear that artificially increased investments in certain assets could lead to “green bubbles” which in turn would increase the risks, questioning the appropriateness of the special treatment of such assets. On the other hand, unjustified dis-incentivising of long-term investments could result in lack of investment in sustainable activities.

It is important that regulatory frameworks, which aim at guaranteeing the security offered to pension savers, do not pose an unjustified barrier to long-term investments. Providers will invest long-term if the applicable framework under which they operate does not act as a deterrent. This means that pension providers may not invest in long-term sustainable assets when the regulatory framework requires excessively high capital charges compared to the risk such assets pose to the institution and ultimately the pension savers. It has proved to be a challenge to find methodologies and calibrations that both ensure the adequate protection of pension savers and adequately capture the long-term nature of pension liabilities (see also section 2.2.2.5).

¹⁹¹ See Section IV “How institutional investors integrate ESG factors” in OECD, Investment governance and the integration of environmental, social and governance factors, 2017, <https://www.oecd.org/finance/Investment-Governance-Integration-ESG-Factors.pdf>

3.7. Limited availability of specific sustainable investment instruments

The current limited offer of specific sustainable investment instruments with a long-term impact on sustainability affects the ability of providers to invest in such assets.

There is currently limited availability of specific investment instruments that have a positive, long-term impact on environmental and social sustainability, like green bonds, social bonds and sustainable infrastructure investments. Although the green bond market is expanding rapidly, it still accounts for only 1% of total bonds outstanding worldwide¹⁹². Moreover, common (EU) standards and labels are still lacking for sustainable financial products, potentially compromising the integrity of the sustainable financial market (e.g. “greenwashing”) and discouraging investors seeking access to such assets¹⁹³.

In order to fulfil their long-term liabilities, pension providers need access to a wide range of suitable long-term investments. These assets need to have characteristics that enable providers to manage their balance sheet in an optimal way and thus meet their investment goals. These characteristics include: risk/return, duration, liquidity, contribution to a diversified portfolio. The scarcity of sustainable impact investments may drive up prices which in turn reduces the attractiveness of the investments.

However, even in the absence of specific investment instruments, pension providers are able to take into account ESG risks and consider the long-term impact of investment decisions on sustainability. A significant number of supplementary pension providers already have responsible or sustainable investment policies in place using various approaches, like:

- Integration of ESG factors by excluding or underweighting and overweighting of sectors or companies with respectively poor and favourable scores on ESG metrics;
- Best-in-class investing by selecting the best performing companies on ESG issues within an economic sector;
- Engagement with companies that score poorly on ESG metrics in order to improve their ESG performance;
- Impact investing by selecting assets that have a positive long-term impact on ESG factors even though this may lead to lower returns¹⁹⁴.

Investing in ESG: pension provider examples

Recent reports have highlighted that ESG has taken up an increasingly important part in the

¹⁹² See G20 Green Finance Study Group, G20 Green Finance Synthesis Report, 2016, <http://www.g20.utoronto.ca/2016/green-finance-synthesis.pdf>

¹⁹³ See the Report on EU Green Bond Standard published on 18 June 2019 by the EU Technical Expert Group on Sustainable Finance, https://ec.europa.eu/info/files/190618-sustainable-finance-teg-report-green-bond-standard_en.

¹⁹⁴ See for example DNB, Sustainable investment in the Dutch pension sector, 2016, https://www.dnb.nl/en/binaries/Sustainable_investment_in_the_Dutch_pension_sector_tcm47-346418.pdf

investment policy of pension providers, including investments in green infrastructure, green bonds, energy efficient buildings, impact private equity vehicles and other sustainable products¹⁹⁵.

In the Netherlands many pension providers, in particular the large ones, are taking into account ESG factors as an integral part of the investment process¹⁹⁶, for example by adopting a thorough responsible investment policy. This responsible investment policy may apply to all asset classes.

A large Belgian provider has integrated climate awareness into its real estate portfolio by developing green buildings (that adhere to the highest efficiency standards in Europe) and also investing in parking facilities, which feature electric vehicle charging options as well as air purification systems¹⁹⁷.

In 2018, a Swedish pension provider has achieved its target of owning green bonds, representing 6% of their managed assets, and making it one of the world's largest private investors in green bonds. For all its green bond investments the provider requires that they must satisfy the Green Bond Principles (which aim to improve transparency and reporting), to which it is also a signatory. It also applies other responsible investment policies¹⁹⁸.

3.8. Investing in accordance with ESG preferences of pension savers

It may be challenging for members and beneficiaries of supplementary pension schemes to sufficiently express their ESG investment preferences and for collective schemes to factor in individual ESG preferences.

EU citizens of all ages are increasingly concerned with social equality and solidarity, and environmental protection issues.¹⁹⁹ As a result, the interest for sustainable finance is growing among existing and potential beneficiaries of supplementary pensions.

Yet it is challenging for citizens to save for retirement income in line with their ESG preferences for a number of reasons.

First of all, it is difficult to find reliable and comparable information about ESG factors taken on board in existing supplementary pension products. Furthermore, there is also a lack of easily

¹⁹⁵ *Ensuring a low carbon future*, UNEPFI, <https://www.unepfi.org/psi/wp-content/uploads/2019/09/AODP-Insuring-a-low-carbon-future-fullreport.pdf>

¹⁹⁶ See, for example, *Benchmark Responsible Investment by Pension Funds in the Netherlands 2017*, <http://www.eurosif.org/wp-content/uploads/2017/10/VBDO-Benchmark-Pension-Funds-2017.pdf>

¹⁹⁷ *Ensuring a low carbon future*, UNEPFI.

¹⁹⁸ *Ibid.*

¹⁹⁹ See European Commission Reflection Paper *Toward a sustainable Europe by 2030*, 2019, https://ec.europa.eu/commission/sites/beta-political/files/rp_sustainable_europe_30-01_en_web.pdf

accessible information on the way decisions are made by providers regarding which ESG factors they support in their investment strategy.

In so far as personal pensions are concerned, intermediaries of investment firms and insurers are required to assess clients' investment objectives and risk tolerance in order to recommend suitable personal pension products. However, ESG preferences of customers are often not sufficiently taken into account when advice is given. In addition, there is a lack of harmonised standards and labels for sustainable (pension) products.

As for occupational pensions which are collective schemes, it may prove to be difficult for the pension provider to take into account the ESG preferences of their individual members and beneficiaries on sustainability aspects and to reconcile potentially diverging views on ESG investments. The governance structures set out in domestic social and labour law and the role of social partners may also play a role in the investment policy.

Disclosure of information on sustainable investments: examples from the EU and France

Newly introduced EU legislation aims to address this issue. For example, the **IORP II Directive** requires IORPs to specify in the information to be given to prospective members whether and how ESG factors are considered in the investment approach.

The EU **Regulation on sustainability-related disclosures** in the financial sectors obliges providers of all financial products, including pension products and schemes, to include in pre-contractual disclosures:

- the manner in which sustainability risks are integrated into their investment decisions and the likely impact on the returns;
- whether and how adverse impacts on sustainability factors are considered;
- information, if relevant, on how the promotion of environmental and social characteristics is met;
- information, if relevant, on how the objective of sustainable investments is attained.

At national level, **France** is one of the first EU member states to adopt provisions regulating the functioning of financial institutions with regards to sustainable investment. The 2015 'Energy Transition Law' sets out an ambitious framework for the reduction of greenhouse gas emissions and the decrease of energy consumption based on non-renewable sources of energy, such as fossil fuels and nuclear power. Article 173(3) of the Law has been a novelty at global level, introducing the mandatory requirement for institutional investors to disclose in their annual report how their activities promote environmental goals. These investors, among which are

banks, insurance companies, asset managers and pension funds, have to indicate:

- how they take into consideration ESG criteria in regard to their investment decisions;
- how they align their policies with the French national strategy referring to environmental and energy transition strategy.

3.9. Sustainability risks and supervisory risk monitoring

Since methodologies for the monitoring of sustainability risks are still under development, supervisors are not yet sufficiently equipped to adequately estimate the impact of long-term environmental and social risks on pension providers and financial stability.

While interest in sustainable investment has been steadily growing for a long time, regulators and supervisors only recently started to look at sustainability as a potential micro- and macro-prudential risk. Traditionally, risk monitoring by supervisors has focussed on risks materialising over short time horizons and their impact on pension providers and financial stability. Environmental and social sustainability risks which materialise over long time horizons were not explicitly taken into account. New models and methodologies for assessing transition risk and the impact of climate-related damage are being developed²⁰⁰, but are arguably still in their infancy. In consequence, supervisors are not yet equipped to adequately estimate the impact of such ESG sustainability risks on pension providers, members and beneficiaries, sponsors and financial stability²⁰¹.

²⁰⁰ See for example 2° Investing Initiative, Out of the fog: Quantifying the alignment of Swiss pension funds and insurances with the Paris Agreement, October 2017, <https://www.bafu.admin.ch/bafu/en/home/topics/climate/info-specialists/climate-and-financial-markets.html> ; and DNB, An energy transition risk stress test for the financial system of the Netherlands, Occasional Studies 16-7, 9 October 2018, https://www.dnb.nl/binaries/OS_Transition_risk_stress_test_versie_web_tcm46-379397.pdf

²⁰¹ See for how a late and sudden transition to a low-carbon economy may impact financial stability ESRB, Too late, too sudden: transition to a low-carbon economy and systemic risk, ASC Report No 6, February 2016, https://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_6_1602.pdf.

Recommendations to address the challenges identified in chapter 3

In view of the challenges outlined above, the High-level Group of Experts on Pensions **recommends that:**

The EU, Member States and the European social partners should:

- **develop cost-effective tools and methodologies to assess the vulnerability of pension providers in the EU to long-term environmental and social sustainability risks;**
- further clarify the social dimension within ESG.

The EU should:

- clarify how pension providers can take into account the impact of ESG factors on investment decisions;
- convene an expert group to prepare voluntary guidance on how pension providers can better understand and model ESG-risks and their relation to “traditional” financial risks in their portfolios;
- ensure that the sustainable investment rules are compatible and consistent with other regulatory requirements and avoid duplication, in particular as regards transparency and information disclosure;
- complete the development of clear, robust and comprehensive taxonomy of ESG factors that facilitates forward-looking investment decisions of pension providers and underpins an EU quality label for ESG products.

ANNEX: Tables and figures

Table I. Coverage of supplementary pensions by type, 2016, % of population aged 15-64

	Occupational pensions	Personal pensions
Austria	15	23.8
Belgium	59.6	38
Bulgaria	0.2	12.9
Croatia	1.1	9.3
Cyprus	39.1	..
Czech Republic	n/a	52.6
Denmark	63.4	18
Estonia	n/a	12.3
Finland	6.6	19
France	24.5	5.7
Germany	57	33.8
Greece	1.3	..
Hungary	..	18.4
Ireland	35	12
Italy	9.2	11.5
Latvia	1	17.1
Lithuania	..	2.8
Luxembourg	5.1	..
Malta
Netherlands	88.0	28.3
Poland	1.6	~10
Portugal	3.7	4.5
Romania	n/a	3.3
Slovakia	n/a	26.3
Slovenia	36.5	1.4
Spain	3.3	15.7
Sweden	~70	24
UK	43 (total)	

Source: Pension Adequacy Report 2018. Notes: n/a – not applicable; .. – not available.

This table is based on the taxonomy of supplementary pensions provided in the 2018 Pension Adequacy Report and the Introduction of the present report and aims to illustrate the varying importance of supplementary pensions in European pension systems. Any taxonomy is, by necessity, a simplification. For a more detailed description of the pension systems and schemes in question, please refer to [Volume II of the 2018 Pension Adequacy Report](#).

Table II. The required savings amounts at retirement age for a 2% indexed, non-lifetime annuity of €1000

The following table, quoted from a Belgian pension insurance handbook²⁰², illustrates the hypothetical savings amounts required for a monthly retirement income of €1000 during a pre-determined period of time (based on an assessment of longevity by the saver), assuming different return rates. The simulation assumes retirement at 65, lump-sum pay-out reinvested in the market, monthly withdrawal of €1000 indexed at 2% per year and no administration costs.

€1000 monthly from the age of 65 until...	chance ²⁰³	real return on investment after inflation of 2% without costs				
		1%	2%	3%	4%	5%
... 80 years	75.03%	191,990	178,082	165,600	154,372	144,250
... 90 years	41.33%	336,685	296,804	263,277	234,949	210,894
... 100 years	8.74%	496,361	415,526	351,874	301,305	260,768
... 110 years	0.15%	672,570	534,247	432,236	355,950	298,091

An example to clarify the reading of this table: at the age of 65 a capital of €191,990 is required for a monthly withdrawal of €1000 indexed at 2% a year with the capital being reinvested at a real return of investment of 1% during 15 years (till the age of 80). After 15 years, the pot is empty. In the example, the chances of a 65-year-old male in 2018 to reach 80 years of age are 75.03%. The amount needed to make the same withdrawals until age 90 is €336,685.

With a higher real net investment rate of for example 3% a lower capital at the age of 65 is required: €165,600 till age 80 or €263,277 till age 90. Given the overall data on savings it is presumably correct to suggest that the required amounts of needed capital to supplement statutory pensions are very substantial or even extensive for a lot of Europeans.

The table above is also indicative for the measurement of real average rates of return in pension schemes. The differences between the real investment return rates of 1% to 5% are strong. The cumulative investment effect over time is key: the longer the savings period, the less the average required amount to save.

²⁰² Vereycken L., Van Eesbeeck, P., *Supplementary pensions for independent workers*, Kluwer, Mechelen, 2016, pages 22 and 23 (in Dutch)

²⁰³ Chances of survival at the starting age of 65 for a male according to the official mortality tables. Some literature suggests these tables may overestimate the mortality risk, given the increasing longevity.

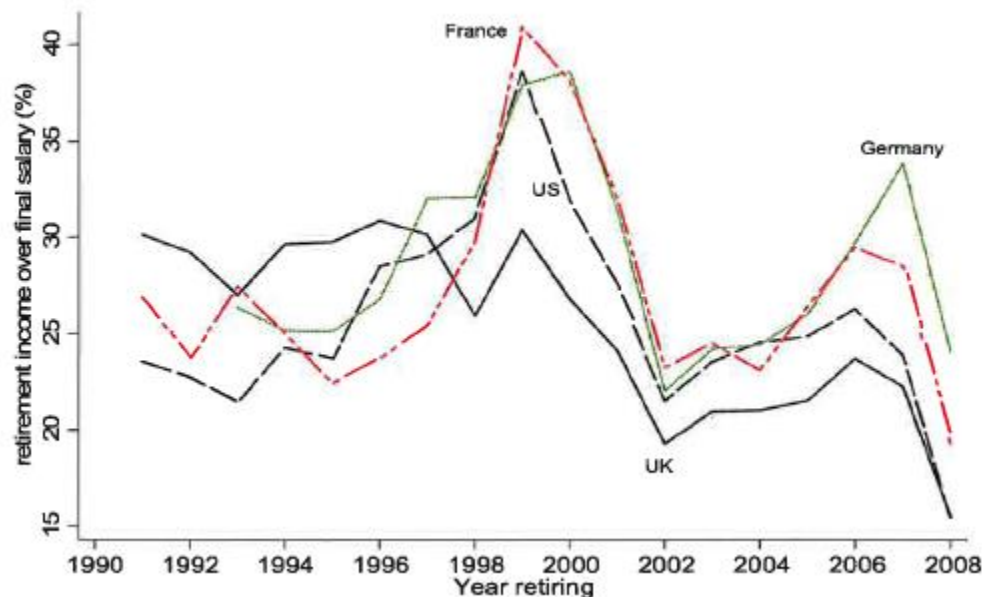
Table III. Impact of costs and charges on final pensions

Charges as % of assets	Reduction of pension pot %
0.05	1.2
0.15	3.6
0.25	5.9
0.50	11.4
0.75	16.5
1.00	21.3
1.50	29.9

Source: OECD Pensions Outlook 2018

The potential impact of costs and charges on the value of retirement savings can be large. Table III shows the impact of total charges on the pension pot accumulated in a theoretical DC account under certain assumptions. Charges of 1.5% of assets would lead to a reduction of nearly 30% of the final pot at retirement, relative to a situation of no charges; halving charges to 0.75% of assets brings the reduction of the pot to less than 17%. The effect of compounding is likely to be significant in an asset-based charging structure: if an individual joins a DC scheme at age 25 and withdraws his entire pension pot at the age of 65, charges will be paid on the first contribution 40 times. Charges will also be paid each year on the prior years' investment returns.

Figure I. The impact of the moment of retirement on theoretical replacement rates in DC schemes in selected countries



Source: Antolín, P. and F. Stewart (2009), "Private Pensions and Policy Responses to the Financial and Economic Crisis", OECD Working Papers on Insurance and Private Pensions, No. 36, OECD Publishing, Paris, <https://doi.org/10.1787/224386871887>

Notes: The impact of the timing of retirement on retirement income is measured by the ratio of retirement income to the last salary (i.e. replacement rate). The exercise assumes that individuals enter the workforce at age 25, works steadily for 40 years and retire at age 65. They contribute 5 percent of wages each year to a pension account investing 60% in equities and 40% in bonds. Additionally, the exercise assumes that wages growth 2 percent annually in real terms. It uses each country major equity index to measure returns on equities and the returns on long-term government bonds to measure returns on fixed income investments. Finally, in order to calculate replacement rates, the exercise assumes that at retirement individuals buy an annuity. The annuity payment is determined by the value of assets accumulated at retirement, life expectancy set at 20 years, and the long-term riskless interest rate prevailing at the time of retirement.