OPSG

OCCUPATIONAL PENSIONS STAKEHOLDER GROUP

Advice on funded pensions contribution to income in later life, growth and employment

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Preliminary remarks: This paper should be read as a simple reflection paper, deprived of any normative ambitious, and even less of one-size-fits-all recommendations to the EU Member States. The OPSG is aware that pension systems differ a lot across Europe, and that some of them already work well. The aim of this paper should be rather considered as "food for thoughts" containing ideas, reflections and proposals that might inspire some decision makers and stakeholders.

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The OPSG highlights the importance for the Member States of the EU to have solid pension systems and developed funded pensions not only to contribute to secure adequate income in old age, but also to strengthen growth, employment and the stability of the euro area. In this respect, the OPSG welcomes the initiatives taken within the Capital Markets Union (CMU) 2020 action plan[1], including the initiative on pensions dashboard, on which the OPSG delivered an Advice[2], and the Report on auto-enrolment[3].

The economic/financial situation affecting one or several EU Member States - including their pension systems - has an impact on the other Member States. This is the reason why recommendations to Member States to adjust their pension (social security and labour) systems are contained in the annual Country Specific Recommendations of the European semester, because macroeconomic imbalances - including pension expenditure - may affect the euro area as a whole. Since the adoption of the European Pillar of Social Rights and the revised social scoreboard, more attention in the European semester process and its Country Specific Recommendations is given to the question of minimum pension adequacy.

More in general, the EU is progressively expanding, directly or indirectly, its legal competences and/or political influence through legislation and jurisprudence related amongst others to the EU fundamental freedoms, the EU internal market, the Europeanization of supervision (ESAs including EIOPA), the European Economic Governance with its aforementioned Country Specific Recommendations, and other specific initiatives such as the EU Charter of Fundamental Rights or the new Support to mitigate Unemployment Risks in an Emergency (SURE), etc.

1 https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/capital-markets-union-2020-action-plan/action-9-supporting-people-their-retirement_en
2 https://www.eiopa.europa.eu/document-library/advice/eiopa-advice-pensions-dashboard_en
https://www.eiopa.europa.eu/document-library/shg-advice/opsg-advice-pensions-gap-dashboard
3 https://op.europa.eu/en/publication-detail/-/publication/6f40c27b-5193-11ec-91ac-01aa75ed71a1/language-en

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The OPSG stresses the importance of multi-pillar/mixed pension systems and recognizes at the same time the challenges relating to the introduction or strengthening of funded pensions in those EU Member States that are still heavily depending on PAYG systems in cases, in which such systems would result in a too severe financial burden for public finance.

Adequate and sustainable pension systems, even if quite different from each other, have a common feature: they <u>are mixed, in the sense of relying on an important funded part in addition to a tax based or PAYG pillar.</u>

Just for clarity, here the notion of "mixed" pension system might be meant as wider than "multi-pillar", considering that in some countries a funded part is also included in the so called "first pillar" (the so called "first pillar bis").

While recognizing that the development of funded pensions mainly remains a national responsibility, the OPSG considers that the EU has also a role to play to ensure that national pension systems remain financially sustainable and are able to provide European citizens with an adequate income in retirement. In this context, the OPSG believes that providing citizens with incentives to contribute to funded pension schemes may not be sufficient to achieve these goals in some Member States; in other words, introducing mandatory obligations and/or nudging mechanisms may be necessary.

After all, after Brexit, the Netherlands alone holds more than a half of the total occupational pension funds' assets of the 27 EU Member States, which means that there is a long way to go to develop funded pensions in Europe. At the same time, it must be taken into consideration that - depending on the national legislation - occupational pensions are not only offered by IORPs, but by life-insurers, asset managers, non-financial companies (employers themselves), etc. In some EU Members State, these different "pension vehicles" are in total even more important than IORPs (like in Germany).

The OPSG is also aware that <u>for some EU Member States still depending on PAYG systems with high contributions, the introduction of mandatory obligations and/or nudging mechanisms to funded pensions requiring additional contributions to complementary pension schemes might represent an obstacle, given the limited room</u> some workers and employers may have to contribute to occupational pensions and/or individual private pensions, especially for low-income individuals.

The OPSG suggests a possible way to address this challenge[4], recognizing that this is only one of several possible solutions, which might not be applicable or suited to every country.

[4] Basically, the idea is to redirect part of the mandatory contributions paid to PAYG schemes to funded pensions and to postpone payments of PAYG pensions later on retirement with the understanding that individuals would start receiving income from their funded pension schemes as soon as they retire. In the long-term public PAYG systems could be therefore relieved because they would start paying pensions later than is presently the case. This would reduce the cost of public pensions in national budget, which would leave some room to reduce pensions contributions to PAYG schemes and redirect them toward funded pensions without increasing of the overall pension contribution. However, in the short-term concerns for the sustainability of public pensions schemes should be addressed.

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The OPSG analyzes funded pensions in the context of the new economic, and cultural societal trends, such as the individualization of pensions, freedom of choice for members in handling their funded pensions, the structural changes of labor market and mobility of workers in the EU.

The current low yield environment, long-term biometrical trends, and other related causes[5] led to a gradual shift from DB to DC pension systems in some Member States, but within that process some pension systems have become closer to a saving scheme and their redistributive functions have been reduced.

Moreover, several pension reforms (reduction of future pension benefits with fewer guarantees), have been mainly - if not exclusively - affecting the new generations. In some Member States, the concept of "intergenerational solidarity" was strongly weakened. Nowadays, young generations may be living in a very uncertain working environment; often receiving lower wages than their parents; inheriting huge public debts implying higher taxes and more expensive labor costs. All that might consequently imply a reduced personal capacity for young generations to save in pensions and public budgets will have on their turn reduced means to finance social protection plans. Therefore, young generations might seriously risk receiving lower social benefits and lower pensions.

In the light of the above, even if several EU Member States are dealing with this issue through progressive taxation, those countries where such imbalances are still so large could consider some redistributive measures aimed at addressing the needs and concerns of the younger generations.

Governments should ensure that their pension system makes sure that all their citizens will not suffer poverty during their old age, and have a decent life in retirement with a regular flow of income from different sources taking into account housing, healthcare, etc. Principle 15 of the European Pillar of Social Rights (EPSR) states that workers and the self-employed in retirement have the right to a pension commensurate to their contributions and ensuring an adequate income. Everyone in old age has the right to resources that ensure living in dignity. In some countries, encouraging or requiring mandatory obligations and/or nudging mechanisms to funded pension schemes (second or third pillar), in compliance with their economic, wage, labour and social features, may be necessary to achieve this goal.

In the light of above, the very first notion of pension adequacy pursued by Governments should be to ensure pension income -independent of the *previous wage income* - permitting pensioners to live not only above the poverty level, but also in dignity, as stated by the aforementioned Principle 15 of the EPSR. Once this income level is reached, voluntary schemes should be left to those aiming at reaching higher pension revenues.

[5] As an example, recognizing liabilities as real debt in accounting and discounting them with low interest rates during the last 20 years.

Informing people about their pension situation including through national and European tracking pension systems (PTS) that give an overview of all pension entitlements incorporating 1st, 2nd and 3rd pillar, should play an important role to allow people to take informed decisions[6]. A PTS must be trustworthy, must be a 'public good' that not solely can help people better trace their pensions, but also serves important general interest goals such as trust in the pension system and facilitate financial planning. The PTS concerns personal information on pension entitlements. Therefore, it is essential that the information is neutral, trustworthy and independent.

Member States should also promote financial education initiatives. In particular, the young generations of today are less likely than in the past to secure a long-term job stability, and so they need more than ever financial know how to build their future pensions. Financial education of beneficiaries should not be underestimated, considering also the large amount of information provided to young people by social media: in such a context, it will be fundamental to be able to distinguish good from bad information[7]. Moreover, also digitalization was strongly accelerated during the pandemic. Digital technology can also have a good potential in democratizing access to finance, but some possible shortcomings should be addressed through digital financial education to enhance to digital products and services. At the same time, it would be a step too far to assume or imply that in a near future people will become suddenly financial experts: that is why financial education should be completed by the obligation of the financial institutions to offer "simple, cost-efficient and transparent" products. Expertise from advisors, good governance, and a strong role for trade unions (especially in occupational pension schemes) is important to protect the interest of participants. High-quality default solutions that are good for the majority with minimal engagement will be necessary as well.

Coverage of pensions is also threatened by significant changes in the labor market. Non-standard employment like permanent part-time, temporary full-time and temporary employment with a part-time regime, or GIG employment are growing. Self-employment, which is growing in the context of the new trends in the labor market, can also be considered problematic for coverage of private pensions insofar as several self-employed workers cannot join occupational pensions and do not often

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[6] With this regard, the EIOPA published a Technical Advice on the development of pension tracking systems on December 1, 2021.
https://www.eiopa.europa.eu/document-library/advice/technical-advice-development-of-pension-tracking-systems_en
Moreover, the OPSG published an Advice on Pension Tracking Systems on September 15, 2021
https://www.eiopa.europa.eu/document-library/shg-advice/opsg-advice-pension-tracking-systems

[7] In a recent Financial Education Conference, it was stated that the fact that personal finance is covered so much on social media today makes it more important and urgent to have financial education in school and colleges, especially the fact that it is the young generation who get financial information from social media and they need to be able to discriminate good from bad information.
Also "Financial education can act as a facilitator in raising societal awareness about the urgency of climate change and can favour the acquisition of the knowledge needed to integrate sustainability into our personal financial decisions (in this case pension funds), so that we can all be part of the change through access to sustainable finance."
"Digitalization is also a key element of recovery. The pandemic has accelerated the acquisition of technology, as well as the digitization of everyday finance. While digital technology can democratize finance, it also has its shortcomings, and some issues need to be addressed. In this regard, it is important to improve the level of digital financial education to enhance access to digital products and services, in particular for some population groups."
https://www.bbvaedufin.com/wp-content/uploads/2021/10/EduFin-Position-Paper-ENG-5.pdf
BBVA EduFin Position Paper "How can financial education contribute to sustainable recovery and inclusive growth?"
https://www.bbvaedufin.com/wp-content/uploads/2021/10/EduFin-Position-Paper-ENG-5.pdf

join private pensions either. Occupational pensions should be made eligible as much as possible; more in general, new forms of pension coverage for those categories of workers should be created in order to avoid dangerous contributory vacuum and poverty risk in retirement. A strong plea can also be made for national labour market regulation in order to enlarge (mandatory) pension entitlements for non-standard workers and solo self-employed work[8].

The increasing (domestic) mobility of jobs and labor status also represents a potential threat to adequate pension coverages. Granted that labour mobility can be very useful for both economy and workers, while some EU Member States[9] succeeded in combining great mobility in their labour markets with excellent pensions, others did not. People might move from an employer offering a workplace pension to another who does not. It might even happen that those people will alternate periods of typical labor contracts with self-employed activities, before joining new employers, etc. As mentioned above, national pension tracking services can play an important role in providing them with simple, precise, and intelligible information across statutory and supplementary pensions. Better insight in personal pension accrual rights, or the lack thereof, seem an important first step in addressing the increasing labor mobility and the question of pension adequacy. Also easing solutions to enhance portability (at least between DC schemes) should be considered to encourage people to keep saving regularly for their pension, no matter what the job status of the person is. However, the OPSG acknowledges, that a too far-reaching portability may not be a reasonable solution for certain DB schemes or will come at the cost of a lower financial yield for the participants of such schemes. In addition, cross-border portability needs fair solutions to take account of the differences between tax incentives to encourage retirement savings over the different Member States. A perfect solution to portability may make in particular EET tax incentives non-viable for Member States, because such portability may result in non-taxation of pensions.

Social dialogue is very important to strengthen the quality of occupational pensions. However, collective bargaining coverage shows a decreasing trend in many EU Member States in recent years. In a number of Member States, there are also challenges related to the involvement of social partners in the policy process in general. Over the last years, several Member States have received Country Specific Recommendations calling for the need to strengthen social dialogue in general. Social dialogue and the quality of industrial relations are at the center of the European social model and strengthening social dialogue is an important policy objective of the European Commission. The Nahles report of ’21 contains important recommendations to improve social dialogue and collective bargaining coverage both at the EU and Member State levels.

As social dialogue is also deeply embedded in occupational pension schemes, the strengthening of social dialogue and collective bargaining coverage at the national level is of fundamental value to occupational pension schemes and pension coverage.

[8] The European Commission proposed a Directive for better working conditions for platform-workers, that introduces a rebuttable assumption of an employment relationship. When coming into force, Member States will have to ensure that national labour law and social security systems (including pension accrual rights) apply to the growing group of platform-workers.
[9] For example, Denmark

Without regard to those mandatory collective occupational pensions (and justified under certain circumstances - by the EU competition law), creating the conditions for the good functioning of a competitive private pension market (both second and third pillar) could also be regarded as valuable. Moreover, considering the aforementioned increasing number of atypical jobs, it might be particularly important for workers and self-employed persons who are not yet eligible to occupational pensions to benefit from cost-efficient personal pensions. The new PEPP initiative could play an important role to encourage potential providers to offer PEPPs and citizens to start saving in a PEPP.

Fintech, including innovative solutions for the distribution of pension products, should be encouraged, while ensuring a high level of consumer protection as expounded above.

With regard to cross-border mobility in the Europe[10], the EU should also continue its initiative in implementing the aforementioned European Tracking service for pensions (ETS) for mobile workers. A European Tracking Service as a central access point to find pensions in different member states, could be an important and adequate means. And of course, a prerequisite to collect individual pension information from different countries via the ETS, is that national PTS are connected to it.

Most workers living and working in another EU country for a specific period of time, have as yet no means to gain insight in their individual pension rights. An ETS would help this group enormously.

However, rethinking about portability of funded pensions across the EU member states should be taken in consideration as well, at least for DC pension schemes (please refer to the paragraph regarding portability above).

Considering the same reasoning above, cross-border pensions (personal and occupational) might represent an added value for a certain type of companies or even high-mobile sectors (however, not for all) and/or individuals within the EU pension landscape. Occupational cross border pensions should be improved by the EU with the support of EIOPA in order to enlighten future discussions including the upcoming review of the IORP II directive.

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Finally, the OPSG highlights the potential for funded pensions to contribute to growth and employment.

In the current situation, further exacerbated by the current COVID-19 crisis, it seems that one of the major obstacles to economic growth and employment may be represented by the huge pressures on public budgets, which are limiting the possibilities for public investment. The ongoing European recovery package (Next Generation EU) is surely mitigating the problem, as well as the possible

[10] In 2019 almost 12 million people of working age moved to work in another EU country. 4,2 % of the total EU labour force. Of those EU mobile workers, approximately 1,5 million are cross-border or frontier workers and 4.6 million are posted workers. For the first 2 years of the posting, the regime of the Country of origin applies for social security rights, amongst which statutory pensions. Employers are solely obliged to ensure so-called hard-core labour standards to posted workers, not including for example supplementary pension rights.

revision of the Stability and Growth Pact might partially help. However, such measures will not solve this issue in the medium-long term, as it has become structural for several EU Member States.

In particular, as long as public pensions' expenditure will represent a significant burden on the public finances of some EU Member States, strengthening funded pensions, together with a gradual reduction of future PAYG pensions expenditure, in cases where they are inefficient and a too heavy burden for public finances, might really represent a fundamental driver to take action.

Well-developed funded pensions might also directly contribute to improvement of the economy as well: as long-term investors, they can make anti-cyclical investments. This appears even more necessary in the current crisis times; providing more flexibility to increase the share of alternative investments would contribute to support the public sector's efforts to invest in sectors like infrastructures; they would also contribute to increase the contribution of capital market instruments to the funding of European companies, including SMEs and start-ups, which still depend heavily on to bank credit in the great majority of cases. However, fostering such forms of investment would also need supervisory authorities actively supporting this development. The heterogeneity of the pension fund market also contributes to the reduction of systemic risks.

In particular, as pension assets grow, there is an increased interest in the costs and societal impact of pension funds' investments. ESG concerns are now becoming increasingly important in the investment market and for the common good. The introduction of ESG regulations can help to achieve the goals of the European Union (Green New Deal) and can contribute to taking care of both financial and other aspects of decent old age.

Finally, the availability of larger pool of capitals is increasingly becoming a new parameter to strengthen the geo-political dimension of the European Union and its members. The Capital Markets Union (CMU) initiative, not coincidentally, also pursues this goal, and the development of funded pensions would play a fundamental role in contributing to achieve this objective.