01/2012

FINNISH CENTRE FOR PENSIONS, SURVEYS

The structure of pension provision and the significance of occupational pensions in different countries

Mika Vidlund, Hannu Ramberg, Antti Mielonen and Elina Lappalainen

Finnish Centre for Pensions
ELÄKETURVAKESKUS

01/2012

FINNISH CENTRE FOR PENSIONS, SURVEYS

The structure of pension provision and the significance of occupational pensions in different countries

Mika Vidlund, Hannu Ramberg, Antti Mielonen and Elina Lappalainen

Finnish Centre for Pensions
ELÄKETURVAKESKUS

Finnish Centre for Pensions
FI-00065 ELÄKETURVAKESKUS, FINLAND
Telephone +358 29 411 20
E-mail: firstname.surname@etk.fi

Eläketurvakeskus
00065 ELÄKETURVAKESKUS
Puhelin: 029 411 20
Sähköposti: etunimi.sukunimi@etk.fi

Pensionsskyddscentralen
00065 PENSIONSSKYDDSCENTRALEN
Telefon: 029 411 20
E-post: förnamn.efternamn@etk.fi

Helsinki 2012

ISSN-L 1798-7113
ISSN 1798-8519 (online)

FOREWORD

This report examines the structure of pension provision and the significance of pension provision agreed in the labour markets in nine different countries. The report consists of two sections. The first section is comparative, whereas the other section (in the original Finnish only) contains descriptions of pension systems in different countries, particularly occupational pensions.

The starting point of our research has been the need to clarify the structure of earnings-related pension provision in certain key countries, as it often has multiple layers and a decentralized administration. The statutory pensions form an important part of pension provision in the countries under comparison, but pensions agreed in the labour market also form a significant share of the total pension of pension recipients.

In addition to the need for information, the European Union has also lately emphasized the significance of occupational pensions as a complement to the statutory pension systems. Due to the increased mobility of its citizens, the EU is also seeking to promote secure occupational pensions that are transferable. Occupational pension provision is thus the focus of increased attention in Finland and other EU countries.

This paper is translated from the original Finnish version by Joanna Nylund. The translated version only covers the first part of the report.

Helsinki 5 October 2011
Mika Vidlund, Hannu Ramberg, Antti Mielonen and Elina Lappalainen

SISÄLTÖ

1 Introduction

In deviation from the Finnish earnings-related pension scheme, the same gainful employment yields pension from more than one pension scheme in many European countries. The total pension is formed from statutory pension and complementing supplementary pension arrangements that have been agreed for the labour markets. Some of these have long-standing traditions; others have only recently been created.

During the last decade, supplementary pensions have attracted increasing attention from the administrative bodies of the European Union. The focus has mainly been placed on improved supervision, guarantee arrangements and the transferability of rights.

Statutory pension schemes are typically pay-as-you-go and thus dependent on, among other things, the population structure. Disadvantageous population structures have a negative effect on the dependency ratio, leading to increased disparity between the benefit and the contribution. Balance is sought through mutual flexibility. This applies in particular to pension levels or other conditions. If the pension benefits remain unsatisfactory, they can be boosted by supplementary arrangements. Such arrangements may be group pension arrangements, individual pension arrangements or other individual means of provision. The arrangements usually involve taxation incentives or public financial subsidies.

The adaptation of the statutory pension schemes to the sustainability goals of public financing has created room for supplementary pensions. The significant size of the supplementary pension funds that have existed longer has also increased the visibility of such arrangements and attracted wider interest. On the other hand, it is also clear to see that the position of supplementary pension arrangements is becoming more firmly established, and may even form a central focus area for the development of the pension system.

The European Union has repeatedly focused attention on occupational second pillar supplementary pensions and related challenges:

- The Laeken Declaration of the European Council references the sufficiency of pensions, the sustainability of the system and, in addition to modernizing the systems, making coverage by supplementary pensions easier, as this is important considering growing needs.[1]
- The introduction to Directive 2003/41[2], given for the operations and supervision of providers offering occupational supplementary pensions, states the growing need for supplementary pensions to complement the social security schemes. Occupational supplementary pensions are not, however, unequivocally considered as social security. The Directive will be reviewed towards the end of 2011.

1 Presidency conclusions – Laeken, 14 and 15 December 2001, conclusion 30.

2 Directive 2003/41/EC of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision, section 5: "Since social security systems are coming under increasing pressure, occupational retirement pensions will increasingly be relied on as a complement in future. Occupational retirement pensions should therefore be developed, without, however, calling into question the importance of social security pension systems in terms of secure, durable and effective social protection, which should guarantee a decent standard of living in old age and should therefore be at the centre of the objective of strengthening the European social model."

- In autumn 2010[3], the Commission released a report on Directive 2008/94/EC in order to monitor the situation of Article 8[4], the protection of supplementary pensions implemented through defined benefit and employer book reserve schemes in case of insolvency of the employer.
- The Green Paper[5] on the development of the pension systems touches upon questions regarding supplementary pensions. One direction of change in pension systems is the shift from single-tier systems to systems of multiple tiers. The White Paper on the development of pension schemes will be published in December 2011.

Especially due to the pension reforms carried out over the last two decades, the structure of pension schemes has changed and the significance of supplementary pensions has increased in most Member States. For this reason, clarifying these systems is important not just due to a growing need for information, but also for the comparability of the Finnish earnings-related pension scheme.

The Finnish earnings-related pension is part of the statutory social security, but our earnings-related pension system has certain features that may also be connected to the supplementary pensions agreed in the labour market. The most important of these are the lack of ceiling in the statutory earnings-related pension scheme, the central role of labour market organizations, and a decentralized earnings-related pension scheme primarily governed by private law, pension insurance companies and funds and the competition between different providers and the (partial) funding of pensions. Compared to other countries, the Finnish earnings-related pension is proportionate to both the statutory and labour market-agreed supplementary pension provision, and fulfils the assignment of both. This is evident from, and can be seen as explaining, the small number of supplementary pension arrangements by international comparison.

The international comparisons of pension schemes are, however, limited almost entirely to statutory pension provision. The omission of the occupational pensions from the comparison not only makes it difficult to compare Finland to other countries, but it also gives a skewed image of pension provision in different countries. A more comparable image of different countries' systems is achieved by also including the occupational pensions in the review. This report continues the tradition of a more comprehensive approach to comparisons of different countries that the Finnish Centre for Pensions has employed in their publications (see e.g. comparison of the overall pension contribution strain between different countries[6]).

The starting point of this publication has been to clarify the central, most comprehensive

3 ESOFAC 12.10.2010: The protection of supplementary pensions in case of insolvency of the employer for defined benefit and book reserve schemes.

4 Directive 2008/94/EC of the European Parliament and of the Council on the protection of employees in the event of the insolvency of their employer, Article 8: "Member States shall ensure that the necessary measures are taken to protect the interests of employees and of persons having already left the employer's undertaking or business at the date of the onset of the employer's insolvency in respect of rights conferring on them immediate or prospective entitlement to old-age benefits, including survivors' benefits, under supplementary occupational or inter-occupational pension schemes outside the national statutory social security schemes."

5 The structure of pension security and importance of labour market pensions in different countries.

6 Vidlund and Bach-Othman (eds.), Pension contribution level in nine European countries in 2005. http://www.etk.fi/fi/gateway/ PTARGS_0_2712_459_440_3034_43/http%3B/content.etk.fi%3B7087/publishedcontent/publish/etkfi/fi/julkaisut/tutkimusjulkaisut/ raportit/elakemaksutaso_yhdeksassa_euroopan_maassa_vuonna_2005_7.pdf

pension schemes agreed on the labour markets of each country, i.e.occupational pension. Occupational pension primarily constitutes arrangements that complement the statutory security, and they are often referred to as supplementary pensions.

The supplementary pension provision agreed on the labour markets may be voluntary or mandatory, and it may be arranged by the employer or individually or collectively, applying to large groups of wage earners. Generally speaking, occupational pensions are not as comprehensive as statutory pension schemes.

In countries where the occupational pensions are based on legislation, coverage has been regulated by law as mandatory, forming a fixed package with the statutory public pensions. However, the legislation that binds occupational pensions is framework legislation, and the contents and conditions of pension provision are primarily agreed among the labour market parties.

The collective arrangements agreed by the labour market parties basically cover only those that are covered by one of the agreements, although agreements can be extended to also cover groups outside the agreement. Since the contents of the pension provision is initially determined per group, pension schemes may thus differ significantly from each other. Certain legislated minimum requirements may apply to these systems by which the scope of the agreement relating to systems may be limited, or certain conditions set in order to receive taxation benefits that in this way steer the operation of the system.

Pension arrangements agreed per workplace are much more limited in coverage than the aforementioned arrangements. Such group or individual pension arrangements may vary, not just between companies but within them. As before, acts specifically steering the operations of such supplementary pension arrangements, such as taxation acts, also apply to countries in this group.

In the so-called traditional three-pillar model of the EU, used internationally to describe the pension provision in its entirety, the occupational pensions typically represent the second pillar of pension provision. The pillar categorization is, in the end, a very crude tool for describing the pension schemes of different countries that have become increasingly multi-tiered over the last few years in particular. The pillar categorization currently appears to cause more confusion than it aids understanding. The classification is also dependent on the perspective that one wants to emphasize when comparing countries to one another. The main emphasis of the categorizations of Eurostat, the social statistics of the EU (European system of integrated social protection statistics, Esspross), the OECD or the World Bank is on whether the system is administered privately or publicly and whether the systems are funded or not.

For example the public pension expenditure calculations of the EPC (Economic Policy Committee), the so-called AWG (the Ageing Working Group) calculations have been made using the categorization of Eurostat, according to which the statutory pensions (e.g. in Sweden and Poland) do not contain fully funded individual pension accounts (e.g. premium pension) but have been categorized as private (supplementary) pensions[7]. However, it is worth noting that even though the administration of funded pensions has been decentralized

7 Classification of funded pension schemes in case of government responsibility and guarantee, Eurostat 30/2004, 2 March 2004.

to private providers, they are financed as part of the statutory pension contribution. Additionally, participation in funded pension schemes is, as a rule, regulated as mandatory for the younger age cohorts of the working population.

The categorization used in this publication differs somewhat from the aforementioned. The comparison includes nine countries: Denmark, France, Germany, the United Kingdom, the Netherlands, Poland, Sweden, Switzerland and the United States. Table 1 shows which pension schemes the occupational pensions are referring to in this publication. In the countries of comparison, with the exception of Poland, occupational pensions make up a significant share of the earnings-related pension provision in the country. In Poland, representing the countries of Central and Eastern Europe (EU12), the supplementary pension provision is only in a build-up phase, and the country represents the manner in which new Member States are constructing earnings-related pension provision through individual pension accounts.

Individual pension insurance and other individual forms of pension savings that have increased in many countries over the last few years, and which are often supported through taxation measures, are mainly left outside this study. Exceptions to this are countries such as Germany and the United Kingdom, where individual pensions form an essential part of the pension solution agreed by the labour markets.

The difference in the ways of arranging supplementary pensions, varying even within the same country, also makes it difficult to create an unambiguous overall picture. The ways used when arranging supplementary pension provision in different countries do, however, have special characteristics that have been reviewed in this study. The formation of supplementary pensions has been affected by the historic development of the labour markets and social security, various industry and trade constructions as well as power relations in society and politics.

Table 1.
Occupational pensions in countries of comparison.

	Statutory pension scheme	Occupational pension	Individual supplementary pension
The Netherlands	National pension (AOW)	Occupational pensions based on sector, employer and occupation	
The United Kingdom	National insurance scheme (S2P earnings-related pension)	Employer-specific supplementary pensions NEST Stakeholder	NEST Stakeholder
Poland	Earnings-related pension Fund pension (OFE)	Employer-specific supplementary pensions (PPE)	IKE pension accounts IKZE pension accounts
France	General social security scheme (Régime Général de la Sécurité Sociale)	Mandatory pensions for managerial and executive staff and employees (AGIRC, ARRCO) Mandatory pensions of the public sector (IRCANTEC, RAFP) Voluntary group and company pensions (e.g. PERE, PERCO, PERP)	PERP
Sweden	Earnings-related pension: Funded pension (Premiepension) NDC earnings-related pension (Inkomstpension) National pension (Garantipension)	Occupational pensions of the private sector (ITP, SAF-LO) Occupational pensions of the public sector (KAP-KL, PA-03) Employer-specific occupational pensions	
Germany	Earnings-related pension	Occupational pensions based on sector, employer and occupation Riester pensions	Riester pensions
Finland	National pension Earnings-related pension	Employer-specific supplementary pensions	
Switzerland	Earnings-related pension (AHV/IV)	Occupational pensions based on sector, employer and occupation (BV supplementary pension)	
Denmark	National pension Earnings-related pension (ATP)	Occupational pensions based on sector and employer	
The United States	Earnings-related pension (OASDI)	Employer-specific supplementary pensions (e.g. 401(k))	

2 The structure of pension systems in the countries under comparison

2.1 The main features of statutory pensions

Although the study focuses on occupational pensions, it is important to look first into the statutory pension schemes and especially on the coverage they are offering. The structure of pension systems in the countries under comparison is quite different, although the statutory pension provision forms the largest share of the overall pension provision in all of them. The statutory pension may be based on residence or work. Of the countries studied in the comparison, pension based on residence exists in the Nordic countries and the Netherlands. In Denmark and the Netherlands, residence-based pension is in a central position since there is no statutory earnings-related pension. Despite the good level of the national pension, this increases the need for supplementary pensions and raises their significance in the pension provision overall. The Finnish national pension and the Swedish guarantee pension (garantipension) are reduced by earnings related pensions and ensure minimum income in case there is no right to statutory earnings-related pension, or if its level is low.

In Finland the earnings-related pension is defined benefit and without an earnings ceiling, i.e. an upper limit for earnings. In Sweden the earnings-related pension is defined contribution, in other words, the amount is dependent on the amount of pension contributions paid. The earnings-related pension is divided between a notional defined contribution pension (NDC) funded through the PAYG principle, and a fully funded pension with benefit that is based on pension contributions and investment profits. The earnings ceiling in the statutory pension scheme is approximately EUR 3,600 per month.

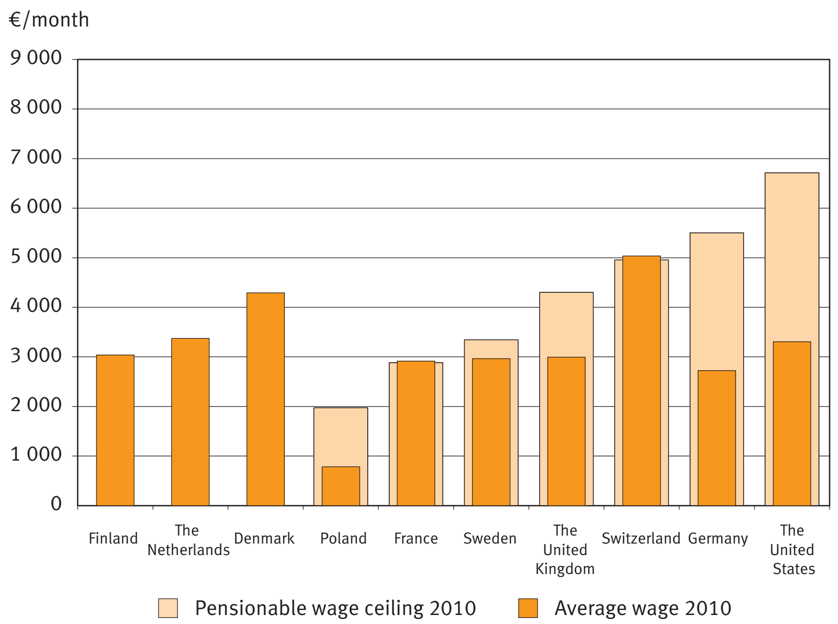
In Switzerland and the United Kingdom, the statutory pension provision is formed from basic pensions with a fixed maximum amount and from earnings-related pension, the target level of which is relatively low. In Switzerland the pension is at least CHF 1,160 (EUR 1,026) and at most CHF 2,320 (EUR 2,052) per month, depending on the earned income. In the United Kingdom, the earnings-related pension scheme is gradually being changed to a flat-rate benefit scheme. In both countries, the basic pension covers everyone resident in the country, and the pension right is based on paying insurance contributions for a certain minimum period of time (the national insurance scheme). In Switzerland, insurance contributions are charged from everyone, also those outside working life. One special feature in the United Kingdom is that the employer and the insured may replace the statutory pension by arranging supplementary pension corresponding to the level of statutory pension (known as opting out or contracting out).

In Poland, France, Germany and the United States, statutory pension provision is based on earnings-related pension provision. The Polish old-age pension scheme was reformed in 1999. Similarly to the Swedish system, it is divided into a notional defined contribution earnings-related pension (NDC) by way of the PAYG principle and a fully funded pension, determined according to pension contributions and investment profit. Contributions are charged from a salary sum below 2.5 times the average salary of the country.

In France, the maximum pension of the statutory earnings-related basic pension scheme is fairly low. A full pension amounts to less than half of the wage ceiling determined for the scheme (EUR 2,885/month), in other words approximately EUR 1,440 per month (2010). Due to accrual regulations, the statutory maximum pension remains low also in the United States, despite a high ceiling for the pensionable wage. The pension is at most a quarter of the highest pensionable wage, EUR 1,700 per month in 2010. In Germany, the earnings ceiling in the old states was EUR 5,500/month and in the new states it is EUR 4,650/month.

The wage ceiling of the statutory pension scheme, in other words the upper limit set for earnings forming the basis of the pension, partly explains how common and necessary the supplementary pension schemes are. Figure 1 presents the wage ceiling in relation to a country's average wage in 2010. In the countries under comparison, the wage ceiling is 1–2 times the average wage, with the exception of Finland, Denmark and the Netherlands, where there is no ceiling.

Figure 1.
Comparison of pensionable wage ceiling in the statutory earnings-related pension schemes of the countries under comparison.



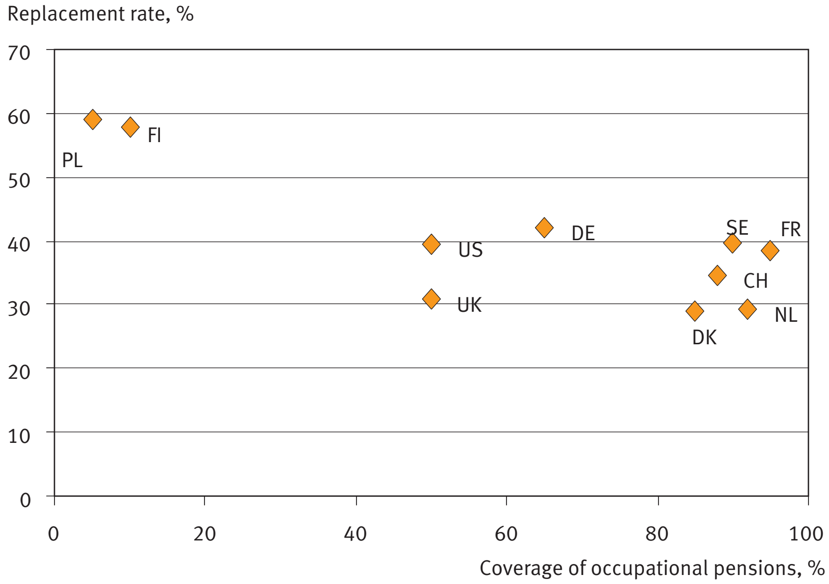
Source: National pension providers; Average salary information: OECD.StatExtracts.

2.2 The coverage of the occupational pensions and the way of arrangement in the countries studied

The significance of supplementary pensions agreed in the labour market for pension provision as a whole varies between different countries, and is partly connected to the level of statutory pension.

In Figure 2, the replacement rate of the statutory pension has been compared to the coverage of the occupational pensions. The replacement rate is based on the future-oriented base-line calculation of the OECD (2011a), and assumes that the insured has worked from the age of 20 until retirement, in Finland to the age of 65. The calculation rules are in accordance with the legislation of 2008. Despite their limitations, theoretical replacement rates provide a picture of the potential level of the statutory pension scheme. The limitations of the calculations are connected to assumptions that differ from real-life observations. For example, the base-line calculations of the OECD and the EU assume an interrupted career with an average wage.

Figure 2.
The theoretical replacement rate of the statutory pension (%) and coverage of occupational pensions (% of employees) in countries of comparison.



Source: OECD

The countries form three groups, with Finland and Poland in the first group standing apart from the rest. In each country, there are relatively few occupational pensions, and the replacement rate of the statutory pension is high. Poland's position in the figure is explained by the mandatory funded pension scheme being categorized as part of statutory pension provision. The size of the funded pension is approximately half of the replacement rate.

The United Kingdom, the United States and Germany form a group of countries where supplementary pension provision is based on the voluntary arrangements of the employer or the insured, and occupational pensions cover approximately half of all employees.

The remaining five countries form a group where the occupational pensions are either regulated as mandatory by law or based on comprehensive collective labour market agreements. Occupational pensions do not normally cover the self-employed and those with short-term employment contracts, meaning that the coverage of the systems is not universal. However, the ways of arrangement have a significant impact on how comprehensively and evenly the supplementary pensions are divided between different groups.

Differences between countries reflect the welfare policy models and categorizations used, but also differences in labour market models and the operations of the labour market parties (see e.g. Esping-Andersen 1990, 1999; Korpi and Palme 1998). According to Esping-Andersen (1999), a comprehensive welfare state is closely linked to a centralized, national and co-ordinated agreement negotiation system for the labour markets, and the welfare state is residual in countries with a dispersed negotiation system and a weak trade union. The Nordic welfare model is an example of the firstly mentioned labour market model above, and the central feature of the countries is the labour market parties' strong participation in the preparation of social policy. The unionization rate of the labour markets is also high (approximately 70 % of all wage earners[8]). This is evident not just from the extensive public social security but also from comprehensive occupational pension arrangements.

In countries that follow the Anglo-Saxon or residual model, occupational pensions are mostly agreed per employer. The coverage of pension arrangements is also the lowest in the United Kingdom and the United States, in other words in countries where, in accordance with the aforementioned, there is a low level of public social security and where the need for market-centred arrangements would be the greatest. The labour market model would thus seem to explain the general nature of the occupational pensions rather than the level of the statutory pension provision.

The Central European countries represent a corporate tradition where the state together with the labour market parties make tripartite agreements involving both the economy and social and labour policies, although the unionization rate is clearly lower (approximately 20 % of wage earners) than in the Nordic countries. A typical feature of the corporate model is solutions that are occupationally differentiated, when, for example, the level of benefits and funding varies per sector or per insurance provider.

The structuring of supplementary pension schemes and their prevalence should thus not be reviewed as directly linked to the level of statutory pension provision, but there is a need to also focus on the way in which occupational pensions are arranged. In the next table (2), countries have been categorized into three groups depending on how the occupational pensions have been arranged. The categorization primarily follows the aforementioned grouping of countries.

Additionally, we have presented either the year when the occupational pension schemes have come into force or another year that is central to the expansion of the system. It is sometimes difficult to determine a fixed point in time, for example for the dispersed supplementary pension scheme of the United Kingdom, in any other way than through structural changes in the statutory pension scheme. Such a change is the 1978 reform that enabled a replacement of the statutory pension with an employer-specific supplementary pension. The situation is naturally easier when it comes to defining the birth of collective and legislation-based systems. For example in Sweden, decisive years include the establishment of occupational pension systems for white-collar employees (ITP) and blue-collar wage earners (SAF-LO) in the private sector in 1960 and 1973. In the public sector and in specific industries, pension schemes have also existed prior to this.

8 http://stats.oecd.org/Index.aspx?DataSetCode=UN_DEN

Table 2.
Arrangement of occupational pensions and central year of enforcement from the perspective of system development.

	Way of arrangement	Coming into force
	Voluntary employer-specific pensions	
The United Kingdom	Contracting-out Stakeholder NEST	1978 2001 2012
The United States	Financing regulation of defined benefit pension and guarantee arrangements (ERISA) Section 401(k) of taxation act that determines taxation of DC schemes	1974 1978
Germany	Separate regulation for occupational supplementary pensions Riester, Entgeltumwandlung	1974 2002
Poland	PPE pensions	1999
	Collective pensions based of labour market agreements	
The Netherlands	Sector-specific agreements	1949
Denmark	Sector-specific agreements	1989–1991
Sweden	ITP agreement of white-collar personnel SAF-LO agreement of blue-collar wage earners	1960 1973
	Mandatory pensions based on legislation	
France	Agirc Arrco All those insured in the earnings-related pension system to Agirc and Arrco (Voluntary PERE, PERCO, PERP)	1947 1961 1972 2003
Switzerland	BVG act of the BV scheme	1985

2.2.1 Voluntary employer-specific occupational pensions

In the country group with voluntary supplementary pension arrangements, efforts have been made to expand the coverage of supplementary pensions, especially in the United Kingdom and Germany. At the same time, the main emphasis of development has moved towards individual occupational pension solutions.

Since 1978, when the statutory earnings-related scheme (SERPS) came into force in the UK, the employer has been able to replace the statutory pension provision of their employees with an employer-specific pension scheme (contracting-out). Replacement arrangements can also be based on labour market agreements and apply to the whole sector of operations, such as in the public sector. However, in the private sector the branch-specific systems are few and far between. Since 1988, individual employees have also got the opportunity to replace the employer-specific system and the SERPS pension with an individual pension arrangement. Changes to supplementary pensions that were legislated in 2007 and 2008 will be coming into force in stages over the period 2012–2016. Then the opportunity to replace the statutory earnings-related pension with DC schemes will be removed and a new, individual DC scheme will be introduced, the National Employment Savings Trust (NEST). All of the insured that do not have auto-enrolment will automatically be included in this system. It is possible to leave the system if one desires to do so.

In the United States, arranging supplementary pensions is voluntary and mainly employer-specific, but all systems must adhere to the supplementary pension legislation in order for pension contributions paid by the company to be deductible in taxation. Primarily due to the continual financing problems of the DB systems, the ERISA Act was enacted in 1974. It tightened the financing and insurance regulations of the systems. Partly due to the increased management and financing obligations of the employers, the popularity of DC supplementary pension schemes began growing strongly in the 1980s. This was partly affected by the 401 (k) addition made to the tax law of 1978, regulating that contributions paid to the employee's DC pension scheme are to be tax-exempt. The supplementary pension provision in the US is increasingly built on the individual responsibility, not just regarding pension contributions but also investment decisions. The share of DC supplementary pension provision already accounts for approximately 80 per cent of the insured.

In Germany, the pension policy decisions on applying a statutory pension contribution ceiling and implementing a sustainability coefficient have partly lead to the relinquishment of index adjustments for pensions (2004–2006) and the cutting of adjustments (2007–2008), as well as stronger growth than before for the supplementary pension provision schemes during the years in question. Additionally, the aim of the direct support paid by the state is to make voluntary pension saving possible also for employees with small and average wages.

The pension reform of 2001 created a state subsidy system that was paid for the first time in 2002, for savings pension contributions paid. State subsidies and tax allowances are included in the incentives. Subsidies can be paid for individual pension savings plans, employer-specific plans or plans agreed in the labour markets. Along with the support system, the so-called Riester pension was introduced (named after a former Minister of Work and Social Affairs). Since the introduction, Riesterpensions have grown strongly, from roughly two million to approximately fourteen million agreements over the last decade. The Riester arrangement may be acquired directly by the individual, or arranged by the employer for the employees. Arranging supplementary pension has traditionally been voluntary for the employer, but in the aforementioned reform at the start of 2002, employees received the right to alter part of the wage to supplementary pension provision (”Entgeltumwandlung”, ”Deferred Compensation”) and the employer was issued a statutory obligation to offer the employees this right.

In Poland, voluntary labour market-based PPE pension schemes became possible in 1999 as part of a comprehensive reform of the pension system. The popularity of PPE schemes, established by the employer, has been modest and in the last few years the main emphasis of development has been on individual pension solutions. An individual, voluntary pension account system called IKE (Indywidualne Konto Emerytalne) was created in 2004, and the system will be completed with the IKZE pension accounts coming into force in 2012. Efforts have been made to make the transfer of insured pension capital between individual pension accounts and PPE arrangements as flexible as possible.

2.2.2 Occupational pensions based on collective agreements

In the Netherlands, Sweden and Denmark, where supplementary pensions have mainly been arranged through collective labour market agreements, membership in the occupational pension scheme has been made mandatory for those working in contract sectors, and the schemes have also been expanded to cover employers, and thus also employees, that have been outside the agreements. For example in the Netherlands, the government may determine that membership in a branch-specific pension fund is mandatory for all companies and employees in the field, by means of legislation and at the request of labour market organizations, if the companies presenting the request represent at least 60 per cent of the employees in the field.

In the Netherlands and Denmark, occupational pensions have been created based on a decentralized model, as different federations negotiate solutions for themselves, and this becomes apparent in how common the branch-specific pensions have become. Whereas in Sweden, the model is closer to that of centralized occupational pensions. Sweden, the four largest contract pension schemes cover approximately 85 per cent of all employees. They comprise white-collar (ITP) and blue-collar employees (SAF-LO) in the private sector, and the employees of the state (PA-03) and municipal sector (KAP-KL).

2.2.3 Mandatory occupational pensions based on legislation

France and Switzerland have supplementary pensions that have been enacted as mandatory and cover practically all wage earners.

In Switzerland, the law governing employer-specific occupational pensions (BVG, Bundesgesetz über die berufliche Alters- Hinterlassenen- und Invalidenvorsorge) came into force in 1985. In the occupational pension acts, only minimum requirements have been determined for the operation of the systems. Lower income limits for mandatory occupational pensions have excluded certain low salary segments and some working outside the system, so taking this into consideration, the coverage cannot be considered universal.

In France, mandatory occupational pensions have covered all wage earners covered by the social security system since 1972. In France, the first supplementary pension arrangement (AGIRC) of the mandatory supplementary pension provision (Régimes complémentaires obligatoires) was created in 1947 as a result of the wage ceiling introduced to the general system, by collective agreement between work supervisors and employers and with the purpose of completing the basic scheme pensions of work supervisors and special professionals. A corresponding system for employees (ARRCO) was created in 1961 and afterwards separate supplementary pension schemes for various professional groups were introduced.

In connection with the great pension reforms of 2003, new opportunities for complementary pension arrangements were created by methods of taxation. A whole group of free-form supplementary pension scheme products (PERE, PERCO and PERP) as well as other free-form arrangements that make use of the taxation acts – Articles 39, 82 and 83 in the Taxation Act – were created.

3 Level of pension provision

The significance of occupational pension schemes to the current income of the insured is still relatively small, as they are mainly complementary pension schemes and have not, until the last few decades, expanded to cover larger population groups, with the exception of certain special groups[9]. In the future, their importance is predicted to grow.

3.1 Defined benefit – defined contribution

The direction of the last few decades has been a shift from public to private, funded defined contribution (DC) pension schemes. The background for this is a preparation for changes in the population structure. In order to control the expenses of the public economy, the aim is to decrease the share of public PAYG pensions in the pension provision as a whole. For occupational pensions, this change is noticeable in DC schemes becoming more popular and the DB schemes and their number of insured declining. For the insured, the shift to DC schemes means a redistribution of risk. In a DB system, risks may be collectively divided between all the payers of pension contributions, or either the employer or the pension provider may carry the risk of pension contribution sufficiency in order to preserve the benefit level that has been promised. In DC schemes, the pension is dependent on the amount of pension contributions paid and the returns received from the pension capital. The contribution level is usually fixed, but investment risks related to pension savings and the sufficiency of the pension will be carried by the insured.

The change has been particularly fast in the 2000s and has been speeded up by the weakening of the capital base, for example due to the value of IT shares crashing at the start of the new millennium, and in the wake of the 2008 financial crisis.

For example in the United Kingdom, so-called old members and a majority of those currently turning to retirement receive their pension from DB pension schemes, but the number of active members has continually declined over the last few years. DB schemes have been closed in the private sector, and new employees are mostly covered by DC schemes. The same development can be seen even more clearly in the United States, where approximately 32 per cent of active members of supplementary pension schemes were covered by DC schemes in 1980, the number going up to 64 per cent in 1995 and onwards to 71 per cent by 2030 (OECD 2009). Currently, approximately 80 per cent of all those insured in the supplementary pension schemes of the private sector are members of DC schemes.

In Sweden, occupational pension schemes were primarily DB still in 1995, but the first decisive step towards changing the systems to defined contribution were taken in the negotiations of employer organization SAF and wage earner organization LO, when the SAF-LO pension scheme was changed into a DC scheme in 1996. The occupational pension scheme of white-collar employees in the private sector (ITP) followed this model roughly

9 See e.g. the comparison of the OECD (2011a) of the significance between public and private income transfer in the distribution of pensioner income based on different sources of income. Public income transfer forms 63 per cent of pensioner income in OECD countries.

ten years later, in 2007. In the public sector, the change has not been as comprehensive, as pensions are defined benefit from the share exceeding the statutory earnings ceiling, and below the ceiling they are contribution based.

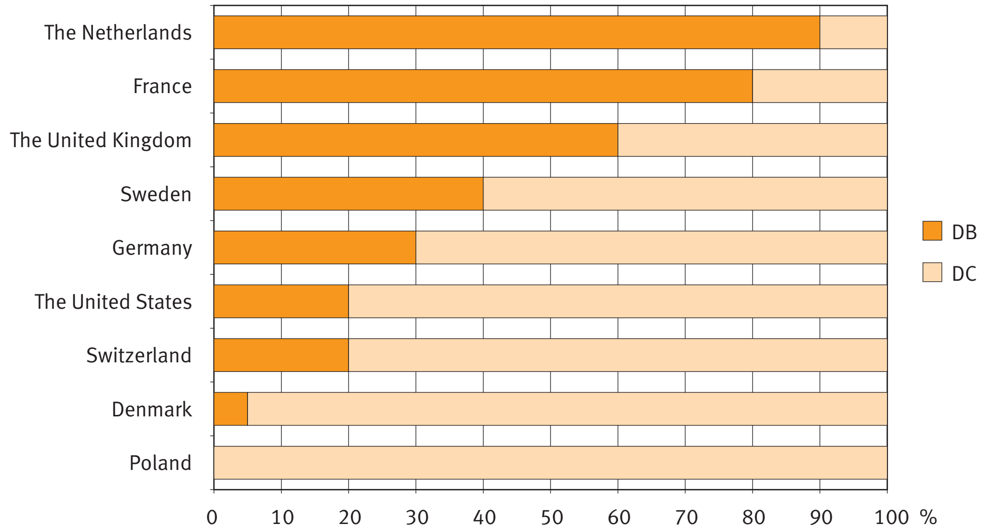
In Switzerland, Poland and Denmark, practically all wage earners are covered by DC pension schemes. In Switzerland, there are certain old DB schemes that complement the mandatory occupational pension. In Denmark, the pension scheme for civil servants is still DB, but a majority of public sector employees and civil servants that used to be covered by the pension scheme have transferred to DC schemes.

In the Netherlands, occupational pension schemes have retained the characteristics of DB schemes, but also there, features have been implemented that resemble DC schemes. In the new DB schemes, indexation of pensions has been tied to the rate of funding in the system. If the rate of funding is low, pensions are not raised fully in accordance with the level indicated by the index. Indexation is thus conditional, and the investment risk can also be transferred to the shoulders of the employees and pension recipients, as is the case with DC schemes.

In the mandatory systems of the private and public sector in France (AGIRC, ARRCO, IRCANTEC, RAFP), pension benefit is determined based on wage points, using the same principle as, for example, in the statutory earnings-related pension system in Germany, and they have been categorized as DB schemes in Figure 3. The value of a point is determined only when the pension is granted, and the benefit level is not promised beforehand. Features of notional DC schemes (NDC) can thus be detected (see e.g. Naczyk & Palier 2010; Legros, 2006; Holzmann & Palmer, 2006). Voluntary supplementary pensions (Articles 82 and 83, PERE, PERCO and PERP) are DC schemes.

In Germany, the employer-specific supplementary pension has most commonly been a direct pension promise based on the employer's pension rule. Direct pensions are funded through the book reserves of the company. Prior to the 2002 pension reform and the creation of a new taxation subsidies, the occupational pension schemes have mostly been defined benefit. The popularity of DC schemes has grown in the last few years, however. This is evident especially from the growth in the number of Riester agreements. At the beginning of 2010, there were 13.85 million Riester agreements (the second quarter). Riester pensions often overlap with other occupational pension solutions. If the Riester pensions are not taken into account, the share of DC schemes accounts for approximately half of all the insured. If the defined benefit/defined contribution share is viewed in relation to premium income or pension assets, the character of Germany's supplementary pension systems can still be described as DB.

Figure 3.
Distribution of active members into DB and DC schemes in 2010.

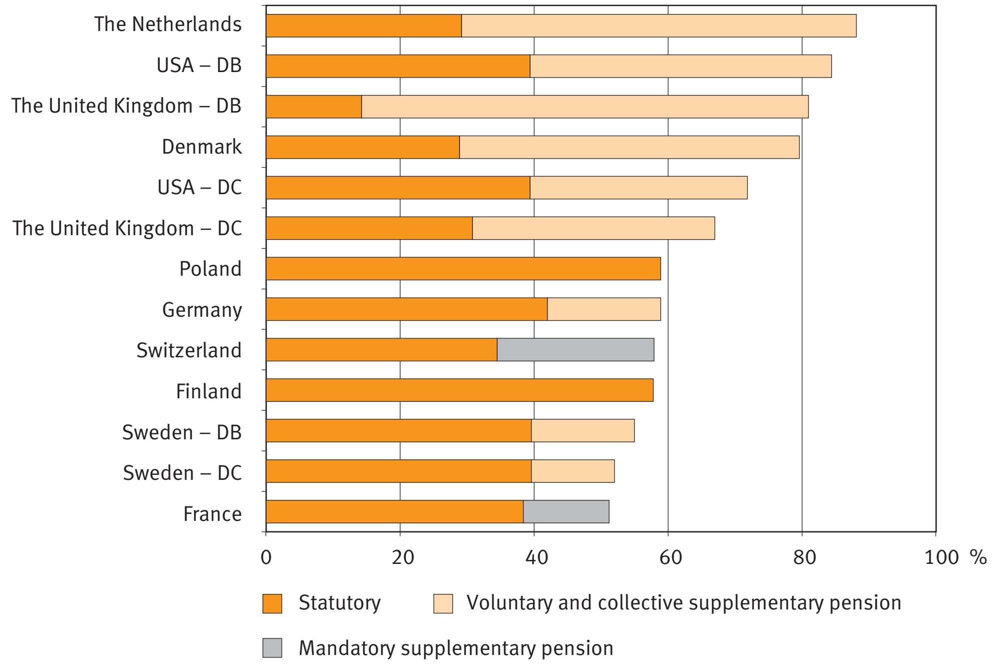


3.2 The replacement rate of the overall pension in countries under comparison

There is no comprehensive statistical information on the level of supplementary pensions and the overall level of the pensions, due to the decentralized nature of the schemes. The following figure shows the significance of supplementary pension schemes to the overall pension provision of a person, illustrated with the help of the theoretical replacement rate calculation of the OECD. The replacement rate depicts the size of the pension of an average wage employee in relation to the wage prior to retirement. The figure separates voluntary and mandatory occupational pensions and statutory pensions from each other, and divides occupational pensions into defined benefit (DB) and defined contribution (DC) schemes.

According to the theoretical replacement rate, the statutory pension is the highest in Finland. Regarding the total pension, the replacement rates are highest in the Netherlands, the United States, the United Kingdom and Denmark. In these countries, over half of the pension is formed from occupational pensions. Another important aspect of the high replacement ratio in the United States and the United Kingdom is that only half of all wage earners are covered by voluntary occupational pensions. A significant aspect in the United States is the general lack of index-linking in the supplementary pension schemes of the private sector. In such cases it is naturally important that the starting pensions are at a sufficient high level, since inflation eats the purchasing power of the pensions over the years. Generally speaking, an increasing share of supplementary pensions to be paid in the future is defined contribution, and increasingly fewer people retire from a DB scheme.

Figure 4.
Replacement rate of statutory and occupational pensions in relation to the average wage.



Source: OECD (2011a) Pensions at Glance for the statutory pension; Private Pensions Outlook 2008: for the voluntary and mandatory supplementary pension.

In the countries reviewed for this report, Sweden, France, Switzerland and the United States have an earnings ceiling set for the supplementary pension schemes.

In Sweden, there is an earnings ceiling in the old DB occupational pension scheme for the private sector (ITP2) as well as in the pension schemes of the municipalities and the state. The earnings ceiling is approximately EUR 14,300 per month. There is no ceiling in the renewed ITP (ITP1) system, now a DC scheme, or in the second large private sector DC scheme (SAF-LO).

In France, the earnings ceiling of the general statutory pension scheme is approximately EUR 3,000 per month, but the mandatory supplementary pension covering the employees (ARRCO) covers earnings up to approximately EUR 8,800 in monthly income. Correspondingly, the supplementary pension scheme of managerial and executive staff (AGIRC) covers earnings up to EUR 23,600 per month.

In Switzerland, the mandatory BVG supplementary pension must cover monthly earnings of at least approximately EUR 6,150, and the employer will arrange voluntary supplementary pension for the amount exceeding this ceiling. At the start of 2006, a wage ceiling was implemented in the voluntary part that completes the mandatory supplementary pension. The wage ceiling is ten times larger than the ceiling of the mandatory system, in other words EUR 61,500 per month in 2011.

In the United States, DB supplementary pensions have a ceiling determined in the taxation acts. The pension cannot exceed EUR 195,000 per year. The ceiling has been linked to the price index. In DC schemes, the pension contributions of employers and employees cannot usually exceed 49,000 dollars or 100 per cent of the salary.

3.3 Indexation and payment of pensions

When the value of statutory pensions is ensured through indexation and the pensions are adjusted through either pricing or earnings indexes or a combination of these, the adjustment procedure for supplementary pensions is considerably more free-form.

In DB schemes, pensions adjustment usually follows the development of prices. In the mandatory schemes of France and the employer-specific schemes of the United Kingdom, the adjustment is linked to the pricing index. This is not necessarily the case, as in the United States the pensions in the private sector are usually not adjusted at all (see e.g. Munnell and Soto 2007).

In DC schemes, the pension capital is dependent on investment returns and they are not raised using separate indexes unless there are guarantee mechanisms in the scheme, in which case a minimum return requirement has been determined for the investments beforehand. For example in Switzerland, an annual interest rate of at least 2 per cent must be paid on the pension capital. The insured can also have the opportunity to choose his or her risk profile, choosing between pension arrangements with guaranteed rate of return profit and unit-linked savings.

Index adjustments are also affected by the results of the investment operations of providers managing the pensions, and on decisions of customer refunds. This is the course of action in, for example, the Netherlands, Sweden, Denmark and Switzerland.

The supplementary pension may be paid as a single instalment (lump-sum) or as a certain period or life-long annuity. The amount of the old-age pension depends on the development of life expectancy. In contrast to the statutory pension, the life expectancy varies between pension providers. For example in Denmark, gender-neutral mortality statistics are used when calculating the pension, and calculation rules are the same for men as for women. The demand for gender neutrality in the rules governing pension calculation is not always met fully, however, as the application is left to the pension funds or companies themselves. 250,000, or 90 per cent, of the members of mutual administrative company PKA (Pensionskassernes Administration) that administers eight different pension funds of the social affairs and health sector (e.g. nurses, midwives) are women (PKA). The longer life span of women compared to men together with the increased risk of disability are directly reflected as lower pension for women compared to more male-dominated pension arrangements. This contributes to raising the already prevalent differences between the sexes in the labour market, for example the wage level in different sectors. (Goul Andersen 2011.)

Practices relating to the vesting rights and transferability of supplementary pensions vary, not just between different countries but also within the country-specific schemes. As the employee changes employer, the pension that has accrued does not necessarily follow along. With the exception of mandatory occupational pensions in France and Switzerland, supplementary pensions are not included in the social security agreements between countries, or EU Regulation No. 883/2004 on social security. In other words, they are not bound by general rules of transferability. In 2005, the Commission put forth a proposal for a directive that was specified further in 2007, by which minimum requirements for the acquisition, preservation and transferability of supplementary pension rights would be set. So far, there is no solution in place for all the employees moving within the EU (see the European Commission 2010).

3.4 Benefit guarantee mechanisms

Altering pension schemes from defined benefit to defined contribution has also meant transferring savings and investment risks more clearly from the employers to the insured. An insured person or someone saving for his or her private pension makingdecisions on single investment measures and carriying the risk relating to investments and changes in investment options, may also lose the savings capital, either wholly or partly. In DC schemes, the operations of the pension providers are governed by set investment rules, and a minimum return requirement can also be set for the pension funds.

In DC schemes, the insured can choose the risk level, as he can make a choice between a traditional pension insurance or a unit-linked funded pension, or a combination of these. In the Swedish ITP scheme of the private sector, half of the pension contribution still has to be invested in traditional pension insurance. In the SAF-LO scheme there is no corresponding safety mechanism. When choosing traditional pension insurance, the pension provider is responsible for the pension capital investments and the insured is promised a set basic pension that varies depending on the provider. The pension may be greater than promised, depending on the investment returns of the company. When choosing the funded pension, the insured chooses how the pension capital is administrated, but this option does not include a guarantee on the size of the pension.

The 2008 financial crisis has raised interest and measures for how to increase the safety of the pensions. As a result, monitoring has been made more efficient and the administrators of the pension schemes are obligated to carry out stress tests and reporting that chart the financial status of the company, leading to even closer contact with the supervisors. For example in Denmark and Sweden, a specific monitoring tool called the traffic light system has been in place for a number of years as a kind of advance warning system. It tests the financial status of the companies and possibly threatening solvency deficits. As solvency weakens, measures are required from the pension providers in order to get it back to acceptable levels. This means e.g. changing the allocation of investments to something less risky. In Denmark, the system expanded to include all life insurance companies and funds in 2001, and the same occurred in Sweden in 2006[10]. Previously, the system only applied to those pension providers whose share of high-risk investments exceeded the set level. The mechanism can be compared to the solvency regulations that guide the operations of Finnish earnings-related pension insurance companies.

The national legislation connected to supervision is also developed across borders. For example, the EU Member States have until 31 October 2012 to begin implementing the Solvency II directive that renews the solvency regulations. The purpose of the directive is to streamline the solvency requirements for insurance and reinsurance companies in the EU Member States, the principles of insurance supervision and well as improve the protection of the insured and recipients of benefits.[11]

Supervision is of central importance to the safeguarding of pensions. Supervision is used to actively prevent any pension providers from going bankrupt. For example in the

10 See e.g. Andersen and Skojdt 2007; Palmer 2008.

11 See more at the Financial Supervisory Authority: http://www.finanssivalvonta.fi/fi/Saantely/Pages/Solvenssi_II.aspx

Netherlands, legislation governing supervision sets a certain economic framework for the pension schemes. If the degree of funding gets too low, the pension fund must prepare a corrective plan and the ideal level must be reached within a certain time period. The measures used are usually raising the pension contributions and changing the level of pension indexation, or both, and measures must be approved by the supervisory authority, central bank DNB. Pensions are indexed according to the increase in wages or prices, should the solvency of the fund allow it. Correspondingly, pensions are not indexed at all if the solvency goes below a certain set level. In between the approach is linear, by index-adjusting pensions in part. On average this means that pensions are adjusted fully according to the index when the solvency of the fund rises to 135 per cent (buffer funds exceed the technical provisions by 35 %). Correspondingly, indexation is not carried out if the funds hold less than 100 per cent of the liabilities.

As a last resort of protection, some of the countries have set up guarantee funds (table 3). The Pension Protection Fund in the United Kingdom was legislated in 2004 and began its operations in 2005. It pays compensation to members of DB schemes in situations where the funds of the pension provider are insufficient and the companies are becoming insolvent. Over 6,500 occupational pension funds are covered. A corresponding federal government agency, the Pension Benefit Guaranty Corporation (PBGC) operates in the United States and safeguards the pensions of DB schemes in the private sector. The annual maximum amount of the compensated pension is USD 54,000.

In Germany, joint stock companies that manage supplementary pensions are bound by legislation to be covered by the mandatory guarantee system, offered by a life insurance company named for the purpose (Protektor – Lebensversicherungs-AG). Pension funds can join the guarantee system of their own volition. For pensions managed by the employer's book reserves in an aid fund, pension foundation and in special cases an insurance company, the guarantee system is offered by the statutory pension insurance association Der Pensions-Sicherungs-Verein Versicherungsverein auf Gegenseitigkeit (PSVaG). As the last guarantor stands the guarantee fund of the state (Sicherungsfonds).

In Sweden, a company that manages the pension arrangements through book reserves must take credit insurance for their pension liabilities from insurance company PRI Pensionsgaranti. Sufficient credit rating is expected from the companies, which means that arrangements based on book reserves are most common in large and medium-size companies. Pensions that are part of the collective agreements of the labour market organizations are safeguarded also in the event the employer becomes insolvent or otherwise neglects his obligations regarding pension contributions. If the employer has agreed on a free-form occupational pension outside the collective agreement, the insured does not have corresponding security.

In Switzerland, the joint guarantee fund of the supplementary pension funds (Sicherheitsfonds BVG-LOB Guarantee fund) is used to ensure their payment capacity, but additionally, compensation is paid from the guarantee fund to such institutions where the age structure of the insured is unfavourable. The guarantee fund is maintained through contributions paid by the pension providers. The fund ensures benefits up to a set maximum limit. When calculating the compensable benefit, the maximum amount of earnings that are taken into account is 125,280 Swiss francs in 2011. (Sicherheitsfonds BVG).

There is no actual guarantee fund in France, but the central employee organization for supplementary pension schemes, ARRCO, and the central organization for supplementary pension funds for management and executive staff (AGIRC) have agreed on joint responsibility between pension providers, and the schemes have been mutually supportive since an agreement was drawn up in 1996. The agreement coming into force in practice meant that ARRCO supported AGIRC, the contribution income of which was small since they were only charged from the income that exceeded the earnings ceiling of the statutory basic scheme. ARRCO received contribution income from income that both exceeded and undercut the ceiling. AGIRC and ARRCO formed a financial consortium in 2002, where the principle of the last provider is implemented[12].

Table 3.
Guarantee funds in countries under comparison.

	Guarantee fund	**Maximum compensation**
The Netherlands	-	-
The United Kingdom	Pension Protection Fund	100 %
Poland	-	-
France	-	-
Sweden	Försäkringsbolaget Pensionsgaranti	100 %
Germany	Pensions-Sicherungs-Verein Protektor Sicherungsfonds	€ 91 800 * *
Switzerland	Sicherheitsfond BVG	100 % pensionable wage ceiling CH 125 280
Denmark	-	-
The United States	Pension Benefit Guaranty Corporation	$ 54 000

* no information.

12 Naczyk & Palier 2010; Laitinen-Kuikka et al. 2002.

4 The financing of occupational pensions

The supplementary pension provision agreed on the labour markets is largely financed by the employer. For example in the Netherlands and Denmark, the employer normally pays 2/3 of the pension contribution. In Sweden, occupational pensions are wholly funded by the employer. The supplementary pension acts of Switzerland determine that the employer must pay at least half of the contribution. In the United States, the split of the pension contributions into employer and employee shares varies depending on the form of the scheme. In DB schemes, the employer usually carries the funding risk alone, while in DC schemes, the employee usually carries the biggest responsibility for the pension contributions.

Table 4 presents the contributions charged from the employer and the insured, or an average contribution describing the scheme. There are variations in the supplementary pension contributions depending on the workplace and sector.

The state usually supports these pension schemes through taxation, either so that the whole contribution or a part of it may be deducted in taxation. In Germany, the state also pays direct support to individual savings accounts or to supplementary pension schemes agreed on the labour markets.

Table 4.
Occupational pension contributions in per cent of the wage in 2011.

	Employer, %	Employee, %	Total, %
The Netherlands	10.9	6.0	16.9
The United Kingdom[1]	DB: 14.9 DC: 6.4	DB: 5.4 DC: 3.0	20.3 9.4
Poland[2]	7.0	-	7.0
France	4.5 – 12.0	3.0 – 8.0	7.5 – 20.0
Sweden	4.5 / 30.0	-	4.5 / 30.0
Germany[3]	-	0.625 – 4.0	4.0
Switzerland	4.0 – 13.0	4.0 – 14.0	17.4
Denmark	8.0 – 12.0	4.0 – 6.0	12.0 – 18.0
The United States[4]	DB: 8.0 DC: 3.0	DB: - DC: 6.0	DB: 8.0 DC: 9.0

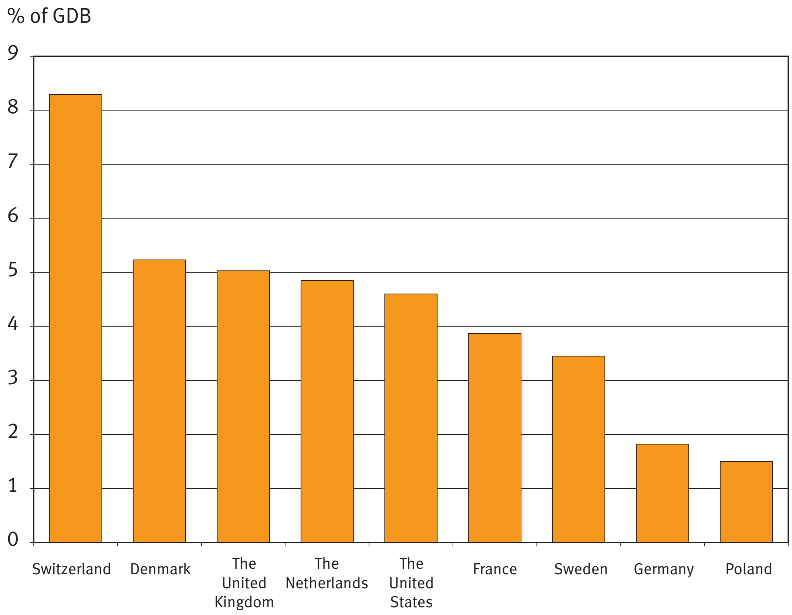
1 Average contribution in 2009 (Office for National Statistics 2011).
2 Maximum contribution according to taxation regulations.
3 Average contribution in the private sector.
4 Maximum contribution according to taxation regulations.

In France, and particularly in Sweden, the contribution is significantly higher for the share that exceeds the statutory earnings ceiling. In Denmark, agreements have regularly been made to raise the pension contributions and several schemes have reached the 12 per cent level defined in labour market agreements in 2009. In some schemes, higher contributions are charged and the contribution is currently 12–18 per cent of the salary.

In Switzerland, there are nominal old-age pension contribution levels, in other words contribution percentages, determined in legislation, on the basis of which the pension capital must accrue in the pension account of each person who is insured. The pension contribution that accrues old-age pension is between 7–18 per cent of the wage forming the basis of the contribution, depending on the age of the employee. The pension funds may themselves decide how to arrange financing in order to meet the minimum requirements set by the law. For example, they may be charging a contribution independent of age, but a majority of the parties involved (60 %) use age-determined contributions. The figures presented in the table are estimates of average contributions made by the social insurance office (BSV).

The contribution volume of the occupational pension schemes, in other words the amount of contribution income in relation to the GDP, was the highest in Switzerland in 2008. Where Switzerland is concerned, contributions not only contain the mandatory minimum level determined in legislation, but also the voluntary occupational pension arranged by the employer that exceeds this. Part of the contribution income does go also to other benefits than directly funding the pensions. Denmark, the United Kingdom, the Netherlands and the United States form the next group. The contribution income was the lowest in Poland, although it contains the entire pension scheme that is managed privately. In addition to voluntary, employer-specific PPE accounts, it includes a mandatory funded pension and individual IKE pension accounts. Figure 5 contains the contribution income of both the private and the public sectors. For the sake of comparison, the contribution income charged from wage earners and employers in the Finnish statutory earnings-related pension provision was 8.6 per cent in relation to the GDP in 2008.

Figure 5.
Occupational pension contribution income in relation to the GDP in 2008.*



* DE: 2005.

The amount of contribution income reflects the contribution percentages above, affected also by the coverage of the pension schemes and the level of benefits approved from them. The contribution level is also affected by how much extra financing is used in addition to contributions charged from employers and employees, in other words mostly the return of investments from pension funds. Fluctuations in the contribution income are usually not great. In exceptional cases, there may be great fluctuations in the contributions of DB pension schemes. For example in the Netherlands, during the crisis that shook pension funding at the beginning of the 2000s, contributions were raised by 40–50 per cent during the years 2001 and 2004 (see e.g. Delsen 2009).

In Denmark, the contribution income has grown steadily. In the early days of the system, for example in 1995, pension contributions were 2.36 per cent in relation to the GDP. Ten years later, contributions were 4.29 per cent of the GDP and 5.3 per cent in 2008.[13]

In Germany, the coverage of the supplementary pension has increased strongly due to, among other things, the increase in Riester pensions, but this has not been correspondingly visible in the contribution income, since contributions to supplementary pension schemes have been low. For example in 2007, the average contribution was approximately EUR 100/month[14]. Book reserves, which are in an important position, also do not show as contribution income.

Supplementary pensions are usually financed by pre-funding the contributions, to a fund or funds managed by a company or independent party. France differs from other countries in

13 Andersen and Skjodt 2007; Rocha et al. 2011.

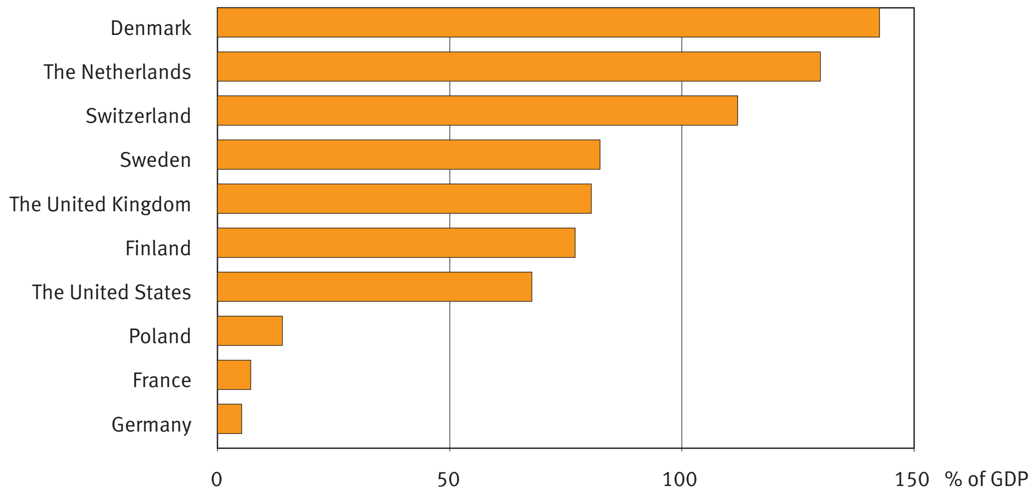
14 TNS Infratest Sozialforschung 2008.

this respect, since the mandatory supplementary pension schemes AGIRC and ARRCO are based on the PAYG principle, and the schemes have only a small buffer fund.

Of countries under comparison, especially Denmark, the Netherlands and Switzerland have accrued considerable pension funds, the sums of which exceed the GDP of the country itself. Figure 6 presents the relation of statutory and private pension funds in relation to the GDP of each country. Pension funds do not contain book reserves, which hold a significant position in Germany, for example. Supplementary pension funds (incl. book reserves) amounted to EUR 53.8 billion in Germany, approximately 18 per cent in relation to the GDP in 2008. Of Germany's supplementary pension funds, a majority, 54 per cent, were in companies' book reserves. 23.6 per cent of funds were in industry-wide pension funds, 11 per cent in pension insurance, 8.2 per cent in relief funds and 3.2 per cent in pension funds. (Arbeitsgemeinschaft für betriebliche Altersversorgung e.V. 2011.)

Figure 6.

Pension funds in countries under comparison in 2009, % of GDP.



Source: OECD Global Pensions Statistics 2011.

5 The administration of occupational pensions

A special feature of the Finnish earnings-related pension scheme is that the labour market organizations hold a significant position in both pension policy decision-making and the implementation of the pension schemes. By implementation is here meant that the representatives of the central employer and employee organizations take part in the management (Boards) of the pension providers.

However, the participation of employer and employee organizations in the management of statutory pension provision (and decision-making in general) is fairly common internationally speaking. In many countries these associations have their representative in the management of social insurance institutions, mostly arranged based on the parity principle (equal participation by employees and employers). Finland may be likened to the group representing a central European management model, as the labour market parties hold a key position in the management of statutory pension schemes in France, Germany, Switzerland and Denmark. In the Netherlands, the labour market parties do not participate directly in the management of the statutory pension scheme anymore after a change in social security legislation in 2001, but the labour market organizations do still participate in all significant institutions that provide advice. The most significant of these is the social and economic board of advisors established in 1950 (Sociaal Economische Raad, SER). Until 1995, the government was obliged to ask the board of advisors for the opinion on all decisions. Although the obligation no longer exists, the co-operation is virtually unchanged. The co-operative body is comparable to e.g. Talousneuvosto in Finland. Another significant advisor to the Ministry of Social Affairs and Health in the Netherlands is the work and income advisory board (Raad voor Werk en Inkomen, RWI), that joins the labour market organizations and municipalities in questions relating to work and income. The RWI is interesting in that it was established in 2002 in order to increase the influence of labour market organizations, as it was considered to have decreased in the 2001 reform.

Participation of labour market parties in the management of occupational pension schemes varies from country to country depending on how pension provision has been arranged. In arrangements based on extensive labour market agreements, the labour market organizations are in a central position. In addition to being represented in the management of pension providers, they may also act as the owners of the providers, such as in e.g. Sweden and Denmark. The labour market parties do not, as a rule, participate in the narrow agreements between a single employer and employee, which means that the arrangement is based on an agreement between the employer and/or the insured and the institution offering financial services. For example in the United Kingdom, supplementary pensions have generally been arranged this way. Also in employer-specific arrangements, the insured are often represented.

Depending on the rules set by legislation and supervision, the power of the labour market parties may be limited, however. For example in Switzerland, the operations of the mandatory BV supplementary pension scheme have been enacted in legislation. In the Netherlands, on the other hand, supervision rules guide the operations of the funds.

Regardless of this, funds in both countries may fairly independently decide on, for example, the indexation of pensions and pension contributions.

Regarding statutory pension, the employer is usually not able to choose the pension provider with whom to arrange pension for the employees. In collective agreement pension arrangements, this alternative may be limited. For example in the Netherlands, collective agreements determine to which branch-specific pension fund all companies and wage earners in the sector will belong to, and this is mandatory. The arguments for this model say that it enables comprehensive, cohesive benefits and contributions for the entire sector, and as a result, equal conditions for competition to all employers in the sector. In completely voluntary arrangements, similar limitations do not exist and the pension can be arranged in different ways.

The possibility of the insured to choose the investment methods or allocations for their pension contributions is dependent on how the pension is arranged. In DB schemes, the insured seldom have the opportunity to affect the investment of the pension contributions, in contrast to DC schemes. Defined contribution schemes based on individual choice include, for example, the stakeholder pension scheme in the United Kingdom, the Riester pension in Germany or the DC scheme 401 (k) in the United States that is mainly based on the choice of the insured. A corresponding opportunity is in the DC schemes of the private sector in Sweden, while in public sector schemes, only the defined contribution part of the pension can be decided by the insured.

In order to increase the participation of the insured and the benefit recipients in different countries, special customer advisory boards and consultative committees have been created in addition to the actual administrative presentation, in order to increase the co-operation between the authorities, interest groups, the insured and policyholders. Often these operate as parties offering advice and can make proposals and give statements on issues relating to pension insurance. In some countries, benefit recipients, i.e. pensioner associations may also be represented on the board of a pension provider.

For example in the United Kingdom and the United States it is common (for reasons of taxation) that an employer-specific scheme has been arranged by establishing a trust. The trustees form an administrative organ that always carries the responsibility for the pension scheme and should act for the good of the benefit recipients regardless of whether it manages the system fund on its own or gives it to an outside party. In the United Kingdom, at least a third of the Board of Trustees should comprise members selected by the insured, with the employer or selected members choosing the rest. In the United States, the composition of the Board of Trustees is not strictly defined in the private sector, in contrast to the public sector where the composition of the Board also can be regulated through local acts.[15]

In the next table (5), a summary shows the participation of different actors in the management of the supplementary pension schemes.

15 ”The trust system was originally an institution of the English legal system but there are corresponding or at least similar schemes in certain other states with an Anglo-Saxon legal culture. There is no definition for the trust scheme in the English court. However, based on practice and legal precedents, it can be described as a system where the settlor (party establishing the trust) gives property to the use of a trustee for the benefit of a beneficiary. Reviewed through the Finnish judicial system, this is not a legal person institution but a fiduciary relationship, although all three aforementioned parties may constitute legal persons. The trust system is not only used to protect those that are close, but also increasingly for commercial interests.” (E. Rajaniemi, Säätiölainsäädännön kehittäminen Arviomuistio, the Ministry of Justice 2010).

Table 5.
Interest groups participating in the administration of pension providers.

	Occupational pension
The Netherlands	A majority of industry-specific funds in which labour market organizations have equal representation. Additionally, representation from the pensioners. Some are company-specific funds where the employees and employers have equal representation. Possibly also representation from pensioners. Insurance companies: no representation from interest groups.
Poland	Fund companies (banks and insurance companies): no representation from interest groups
Sweden	Majority arranged in pension insurance companies, some of which are owned by labour market organizations. Representatives of labour market organizations have equal representation here. Additionally there are insurance providers and banks, without representation from interest groups. Book reserves: credit insurance with the company Pensionsgaranti, where labour market organizations have equal representation. In the industry-wide pension funds, labour market organizations have equal representation.
France	There is equal representation of employers and employees in both the parent organizations (AGIRC, ARRCO) and their member organizations.
Germany	A majority are book reserves: employers Branch-specific arrangements: equal representation for representatives of labour market organizations
Switzerland	Employer-specific fund or pool consisting of several employers (small em-ployers): equal representation of employers and employees. Branch-specific funds: equal representation for representatives of labour market organizations
Denmark	A majority arranged in insurance companies of which some are owned by the labour market organizations. Representatives of labour market organizations have equal representation in these. In branch-specific industry-wide pension funds, labour market organizations have equal representation. In company-specific industry-wide pension funds, there is equal representation of the employer, active members of the scheme and pensioners.
The United Kingdom	Mostly employer and individual arrangements that are mainly organized in trusts. In a trust, at least 1/3 should be active members of the scheme and pensioners. It is up to the employer to decide on the rest of the members.
The United States	Mostly employer and individual arrangements that have been arranged in trusts. In the trust: no defined employee or employer shares in the private sector.In the public sector, the makeup of the board of the trust is oftenregulated by law.

6 Summary and discussion

Several common, characteristic features can be seen in the occupational pension schemes of different countries. The most important findings have been summarized below.

- Occupational pension arrangements have often preceded statutory pension schemes. As statutory schemes have come into force, the occupational schemes have remained in force as occupational pension schemes that either complement or replace other pension.
- The birth of the pension schemes agreed by the labour markets has been affected by the low replacement rate of the statutory pension schemes.
- Occupational pensions are, as a rule, fully funded schemes.
- The coverage and cohesion of the schemes are affected by the actions of the labour market parties in pension policy. Pension schemes have been agreed in a centralized manner or in a decentralized manner at the union level, or per workplace. The more decentralized the agreement is, the more narrow the coverage of the whole work force by the schemes.
- Pension arrangements are usually agreed between labour market parties. The labour market parties determine the level of benefits, contributions and conditions for receiving them. The administrative steering is the responsibility of the labour market parties. Occupational pension may also be narrow arrangements decided by the employer.
- In the same country there may be several ways of arranging occupational pensions. They may be alternatives, and be dependent on a sector of business.
- The employee's pension may be constituted according to many different rules depending on the method of arrangement.
- The implementation of the systems has been divided between numerous providers, and there is usually no co-operation between them.
- There is no comparative information that is comprehensive enough to investigate the average pension amount of pensions currently in payment. However, we can conclude that occupational pensions and other supplementary pension provision cover income to a higher degree the higher the income category reviewed.
- Occupational pensions are usually also regulated by law. In such cases they are limited through different framework laws or taxation laws. Legislation may determine the coverage of a supplementary pension scheme, the preservation of the pension right and safeguarding of the scheme's reserves, as well as the taxation treatment.
- The state supports supplementary pension saving through taxation incentives. The practice of exempt, exempt, taxed (EET) is usually followed, which means that pension contributions are deductible in income taxation up to a certain limit, and investment returns received from the contributions are tax-free. A pension paid is taxable income.
- In relation to pension contributions and the number of insured, schemes may be significant, but when investigating the benefits paid, the statutory scheme still stands for most of the pension provision.

6.1 Realities of population and economy

The Green Paper of the European Commission – for the development of sufficient, durable, safe European pension schemes – has not been published by accident. As supplementary pensions and funded schemes are becoming more important, the need for verifying their functions has increased. The Green Paper is principally a discussion opener, through which extensive discussion was launched in a matter the Commission considers increasingly important. There were no concrete presentations in the paper, but they are expected by the end of 2011.

The financial crises that have tested the funded schemes lately have shown their vulnerability, although it is difficult to draw far-reaching conclusions from singular crises. The development of the pension funds should be reviewed in the long term, accommodating many types of fluctuations in investment returns and stock markets. However, the crises have emphasised the challenges of financing that the ageing of the population brings on. The ageing of the population tests the structure of the entire pension establishment, regardless of scheme or method. Funded schemes are not, however, as vulnerable to size differences in age cohorts as the PAYG systems. With the establishment of the private and funded schemes, the pressure on the statutory or public pension have been diminished somewhat.

Following the 2008 financial crisis, pension funds were able to partly cover their losses immediately in 2009 as the markets rose, and according to information from the OECD (2011b), pension funds in many countries had reached the pre-crisis level by the end of 2010, but e.g. the United States had not yet regained its losses by that time. The downhill trend of the share and interest rate markets has pulled the funding rate of the largest supplementary pension funds of the Netherlands below the required solvency level of 100 %.

6.2 Redistribution of risk between different parties

Based on this report, increasing individual responsibility for the future pension level seems to be a feature also elsewhere than in Anglo-Saxon countries or countries with a Liberalist social security. This is evident especially in the pension reforms of Sweden and Germany, where a main share of the total pension is still based on the collective risk sharing, when taking into account the statutory pension.

In the Netherlands, traditional DB schemes have been changed to DC schemes, and in a riskier direction from the viewpoint of the insured, by implementing pension indexation tied to investment returns and changes in life expectancy. However, it is worth noticing that in some countries, in order to counter the increase of DC schemes that are more risky, efforts have been made to distribute the risk more evenly between the employer and the insured by using hybrid schemes that combine features of DC and DB schemes, or DC schemes that guarantee a minimum rate of return.

6.3 Selectivity of occupational pensions

A typical feature of occupational pensions is that they are selective benefits directed at certain individuals or groups. The coverage of the supplementary pension schemes has grown significantly over the last few decades. In some of the countries in our review, supplementary pensions have been made mandatory in collective agreements or in legislation, with certain conditions attached. These have also been reviewed from time to time, and for example in Switzerland, the lower income level has been lowered to accommodate new groups. In the United Kingdom and Germany, the state authorities have been active in extending new forms of pension saving to larger parts of the population. The coverage of the systems contains shortages concerning employees working in short-term employments or in a typical employment. The self-employed are also usually left outside the arrangements.

This report does not compare how large the differences in pension benefits are between schemes catering to different groups, for example per sector or branch or level of education. The example shown in connection with a description of the Danish system shows that significant differences may exist between different industries. On the other hand, significant differences in the amount of pension may occur even between companies in the same sector. The differences in Sweden, very discernible previously, are balancing out as the ITF and SAF-LO schemes of the private sector have been changed into DC schemes, where the pension is determined based on equal contribution bases. In supplementary pensions created by collective agreement and framework legislation, equality is most likely implemented better than in employer-specific arrangements.

6.4 Main differences to the Finnish earnings-related pension scheme

Certain clear differences to the Finnish earnings-related pension schemes can be discerned based on this report. One such central difference is the almost universal coverage of the Finnish statutory earnings-related pension scheme compared to selective occupational pensions. Earnings from work are covered by earnings-related pension, regardless of income levels and occupational groups.

In Finland, earnings-related pensions form the main share of income for pension recipients. The sufficiency is determined based on a career and unsalaried periods covered by the insurance. A theoretical replacement rate calculation shows that the Finnish earnings-related pension is slightly below average among the countries in the comparison, when reviewing the overall pension level formed from statutory and occupational pensions.

Only the results of the OECD's basic calculation were presented, but a review of alternative assumptions shows that replacement rates may hold significant fluctuations especially in countries where the investment returns in the schemes directly affect the amount of the pension. These are defined contribution, funded occupational pensions. In DB schemes, pensions in relation to wages are better and do not contain the risk resulting from a diminishing number of investments, but as this study has shown, fewer individuals are covered by these. The calculations do not review the change in replacement rate during retirement. This is affected by the adjustment method used for pensions in payment. In occupational pensions, the practice for these is varied.

In the basic calculation of the OECD, there is an average annual rate of return assumption of 6 per cent for investments. It is good to take a cautious approach to the evaluations of the calculation regarding the importance of DC pensions to the replacement rate as whole, with regards to return assumptions on investments. In the alternative return assumptions of the OECD, the impact of the difference between a high (+2 %) and low (-2 %) return is on average 23 percentage points (OECD 2009; Vaittinen 2010). In DC schemes, the final pension amount is also affected by management costs that may vary considerably.

In Finland, the pension is defined benefit, but in practice there are also DC features in the earnings-related pension system. The contribution is not fixed, and investment profit has no impact on the individual benefit, but the pension is determined based on earnings from the whole career and the final pension amount depends on the development of life expectancy. The pension level is also not tied to the end salary.

As in the countries of comparison, the management of the Finnish earnings-related pension scheme is divided between many providers. However, in Finland they are no more than tens, whereas elsewhere there may be hundreds of them. The number of parties involved does not directly refer to the level of competition, since the employer's opportunity to choose pension arrangement administrator may be limited.

From the point of view of the insured, the Finnish earnings-related pension scheme is centralized. This involves applying for pension and equal pension rules for all. A co-ordinated management model also removes the problems of transferability of pension rights that appear to come with occupational pensions. The dispersion of the management model in the comparison countries also affects the possibilities of the insured to receive information on the amount of the accrued total pension and pension rights. In the comparison countries, attention has been paid to the possibilities of the insured to receive comprehensive information on their pension provision, and lately, methods have been created by which to decrease these problems. For example in Sweden and the Netherlands, comprehensive electronic service forms for occupational pensions have been created for this purpose. The mandatory occupational pensions of France implement the principle of the last provider, but voluntary arrangements are left outside this practice.

Occupational pensions are, as a rule, fully funded schemes. DC schemes are fully funded also by definition, as the level of the benefit has not been promised beforehand. The pension benefit can usually be secured with the help of investment regulations and supervision. The last resort security of DB schemes in some countries has been to establish guarantee funds that guarantee the benefits based on certain limitations, if the fund has become insolvent. The Finnish earnings-related pension scheme is also DB, but due to partial funding, the main part of pension costs is covered by the PAYG principle, as there is no corresponding investment risk in that respect. The providers of the pension scheme are also bound by joint liability, by which is guaranteed that pension earned will be paid also in cases of insolvency.

SOURCES

Andersen Carsten ja Skjodt Peter. 2007. Pension Institutions and Annuities in Denmark. The World Bank. Policy Research Working Paper 443.
http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2007/12/12/000158349_20071212140314/Rendered/PDF/wps4437.pdf

Arbeitsgemeinschaft für betriebliche Altersversorgung e.V. (aba). 2011.
http://www.aba-online.de/seiten/index.shtml

Delsen Lei. 2009. Distribution of risk in Dutch pension funds. 15 April 2009. Brussels. Radboud University Nijmegen.

Esping-Andersen, G. (1990). The Three Worlds of Welfare Capitalism. Polity Press.

Esping-Andersen, G. (1999). Social Foundations of Postindustrial Economies. Oxford University Press.

Holzmann, R. and Palmer, E. (2006), Pension Reform: Issues and Prospects for Non-Financial Defined Contribution (NDC) Schemes. Washington: The World Bank.
http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALPROTECTION/EXTPENSIONS/0,,contentMDK:20811726~pagePK:148956~piPK:216618~theSitePK:396253,00.html

Korpi, W. ja J. Palme (1998). The Paradox of Redistribution and Strategies of Equity: Welfare State Institutions, Inequality, and Poverty in the Western Countries. American Sociological Review 63, 661–687.

Laitinen-Kuikka Sini, Bach Jarna, Vidlund Mika. 2002. Eläketurva Länsi-Euroopassa. Eläketurvakeskus, Helsinki.
http://www.etk.fi/fi/gateway/PTARGS_0_2139_459_440_3034_43/http%3B/content.etk.fi%3B7087/publishedcontent/publish/etkfi/fi/julkaisut/k%C3%A4sikirjat/elaketurva_lansi_euroopassa_7.pdf

Legros, F. (2006), 'NDCs: A Comparison of the French and German Point Systems' Teoksessa: R. Holzmann and E. Palmer (2006), Pension Reform: Issues and Prospects for Non-Financial Defined Contribution (NDC) Schemes (Washington: The World Bank), pp. 203–222.
http://siteresources.worldbank.org/INTPENSIONS/Resources/395443-1139338370854/Pension_ch10.pdf

Munnell, Soto. 2007. State and Local Pensions Are Different From Private Plans. Center for Retirement Research at Boston College. Brief number 1.
http://crr.bc.edu/briefs/state_and_local_pensions_are_different_from_private_plans.html

Naczyk Marek, Palier Bruno. 2010. Complementing or replacing old age insurance? The growing importance of funded pensions in the French pension system. REC-WP 08/2010. Working Papers on the Reconciliation of Work and Welfare in Europe RECWOWE Publication, Dissemination and Dialogue Centre, Edinburgh.
http://www.socialpolicy.ed.ac.uk/__data/assets/pdf_file/0018/44082/REC-WP_0810_Naczyk_Palier.pdf

OECD 2005. Pension Markets in Focus. Newsletter, June 2005, Issue 1.
http://www.oecd.org/dataoecd/46/2/35063476.pdfEläketurvan rakenne ja työmarkkinaeläkkeiden merkitys eri maissa 37

OECD 2009. OECD Private Pensions Outlook 2008.
http://www.oecd.org/document/60/0,3746,en_2649_34853_41770428_1_1_1_1,00.html

OECD Global Pension Statistics. 2011.
http://www.oecd.org/document/46/0,3343,en_2649_34853_36091822_1_1_1_1,00.html

OECD.StatExtracts 2011. http://stats.oecd.org/Index.aspx

OECD 2011a. Pensions at a Glance. Retirement-income Systems in OECD and G20 Countries,

OECD Publishing. http://dx.doi.org/10.1787/pension_glance-2011-en

OECD 2011b, Pension Markets in Focus, July 2011, issue 8.
http://www.oecd.org/dataoecd/63/61/48438405.pdf

Office for National Statistics (2010) Occupational Pension Schemes Annual Report 2009.
http://www.statistics.gov.uk/downloads/theme_population/occ-pension-2009/opss2009final.pdf.

Palmer Edward. 2008. The Market for Retirement Products in Sweden. The World Bank. Policy Research Working Paper 4748. http://library1.nida.ac.th/worldbankf/fulltext/wps04748.pdf

Rajaniemi Erkki. 2010. Säätiölainsäädännön kehittäminen. Arviomuistio. Oikeusministeriö.

Rocha Roberto, Vittas Dimitri and Rudolph Heinz 2011. Annuities and Other Retirement Products. Designing the Payout Phase. The World Bank. Washincgton, D.C.

TNS Infratest Sozialforschung 2008 Situation und Entwicklung der betrieblichen Altersversorgung in Privatwirtschaft und öffentlichem Dienst 2001–2007. Endbericht. http://www.tns-infratest-sofo.com/arbeitsber/2550/2550_kurzf1.html

Vaittinen Risto. 2010. Elinkaarisäästäminen ja sijoitusriskit eri eläkejärjestelmissä. Eläketurvakeskuksen keskustelualoitteita 2010:2.
http://www.etk.fi/fi/gateway/PTARGS_0_2139_459_440_3034_43/http%3B/content.etk.fi%3B7087/publishedcontent/publish/etkfi/fi/julkaisut/tutkimusjulkaisut/keskustelualoitteet/elinkaarisaastaminen_ja_sijoitusriskit_eri_elakejarjestelmissa_7.pdf

Vidlund Mika ja Bach-Othman Jarna (toim.) (2008). Eläkemaksutaso yhdeksässä Euroopan maassa vuonna 2005. Eläketurvakeskuksen raportteja 2008:3. Eläketurvakeskus, Helsinki.
http://www.etk.fi/fi/gateway/PTARGS_0_2712_459_440_3034_43/http%3B/content.etk.fi%3B7087/publishedcontent/publish/etkfi/fi/julkaisut/tutkimusjulkaisut/raportit/elakemaksutaso_yhdeksassa_euroopan_maassa_vuonna_2005_7.pdf

Euroopan Komissio 2010. KOM(2010)365 lopullinen. Vihreä kirja: Riittävien, kestävien ja turvattujen eurooppalaisten eläkejärjestelmien kehittäminen. SEK(2010)830. Bryssel 7.7.2010.
http://ec.europa.eu/social/main.jsp?catId=752&langId=en
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52010DC0365:EN:NOT

The Finnish Centre for Pensions (ETK) is a statutory cooperation body for the development and implementation of earnings-related pension provision and an expert on pension insurance. For the evaluation, development and monitoring of pension provision, the Centre produces background surveys on pension provision and its funding.

Eläketurvakeskus (ETK) on työeläketurvan kehittämisen ja toimeenpanon lakisääteinen yhteistyöelin ja työeläkkeisiin erikoistunut tietotalo. Eläketurvan arviointia, kehittämistä ja seurantaa varten se tuottaa taustaselvityksiä eläketurvasta ja sen rahoituksesta.

Pensionsskyddscentralen (PSC) är ett lagstadgat samorgan och sakkunnig inom verkställigheten och utvecklingen av arbetspensionsskyddet samt informationen om det. Pensionsskyddscentralen producerar bakgrundsinformation om pensionsskyddet och pensionsfinansieringen för bedömningen, utvecklingen och uppföljningen av arbetspensionsskyddet.

Finnish Centre for Pensions
ELÄKETURVAKESKUS