

## **PENSION POLICY FROM FINANCIAL POINT OF VIEW IN THE EUROPEAN UNION**

***Dr. Zoltán Varga***

PhD, Associate Professor

*University of Miskolc*

*Faculty of Law*

*Department of Financial Law*

### INTRODUCTION

The European Parliament has been at the forefront of all the major issues relating to pensions, with resolutions addressing points such as the demographic challenge and solidarity between generations (2010), the long-term sustainability of public finances for a recovering economy (2010), the role of women in an ageing society (2010), the impact of the economic crisis on gender equality and women's rights (2013), and the on-going issue of portability of supplementary pension rights (2013). The European Economic and Social Committee voiced concerns in its 2012 Opinion on the White Paper, regretting in particular that the EC does not seek solutions for strengthening public pensions. In parallel, in its Opinion on the White Paper, the Committee of the Regions encourages a stronger social focus in the pension's debate.

### THE PORTABILITY OF THE PENSIONS

The European Parliament, the Council and the European Commission reached a compromise on 27 November 2013 on the directive on minimum requirements for enhancing worker mobility by improving the acquisition and preservation of supplementary pension rights. COREPER endorsed the text on 4 December 2013 and the Employment Committee of the European Parliament adopted the text on 9 December 2013. The Directive does not cover, what is often called "portability" of supplementary pensions, i.e. the possibility of keeping pension entitlements by transferring them to a new scheme in the event of professional mobility. However, the agreed Directive sets out certain rights and obligations for members of supplementary pension schemes.

The directive relates to a European Commission proposal dating back to 2005 on which the Parliament adopted its first reading in 2007. Since then, the proposal has remained blocked in the Council. In 2012 the European Council called for the sustainability of pension systems to be improved and for the acquisition and preservation of supplementary pension rights of mobile workers to be strengthened. Following this request, the Cyprus, Irish and Lithuanian Presidencies have resumed work on the directive. The new rules will be based on Article 46 of the Treaty on the Functioning of the EU (free movement of workers).

Main features of the agreed directive:

- the directive focuses on cases of labour mobility between Member States only. The Council and the Commission have however added a statement to the

minutes of the Council to ensure equal treatment of internally and externally mobile workers. This is up to the Member State. The directive applies to supplementary pension schemes apart from the schemes covered by Regulation 883/2004 and shall only apply to periods of employment falling after its implementation;

- the directive defined the principle of “outgoing worker” as an active scheme member whose current employment relationship terminates for reasons other than becoming eligible for a supplementary pension, and who moves between Member States;

- any vesting periods and/or waiting periods (combined) are limited to a maximum of three years;

- the minimum age for starting the vesting of pension rights, may not exceed 21 years;

- where a worker has not yet acquired vested pension rights when the employment relationship ends, the supplementary pension scheme shall reimburse the contributions paid by the outgoing worker, or paid on behalf of the outgoing worker;

- Member States must ensure that outgoing workers’ dormant pension rights or their values are treated in line with the value of the rights of active scheme members, or the development of pension benefits currently in payment, or by other means, such as: safeguarding the nominal value of the rights or adjusting the value of the dormant rights.

- The Member States must ensure that active scheme members can obtain on request information on how a termination of employment would affect their supplementary pension rights. Furthermore, Member States shall ensure that deferred beneficiaries can obtain on request information regarding the value of their dormant rights or an assessment of the dormant pension rights carried out no more than 12 months preceding the date of the request and the conditions governing the treatment of dormant pension right. A Member State may request that an outgoing worker notifies his/her scheme in case of moving to another Member State.

- In various parts of the text, the role of the social partners is referred to. Implementation of the provisions set out in this directive can be delegated to social partners, as long as provisions implemented by them do not offer less favorable protection and do not create obstacles to the freedom of movement.

- The text mentions that Member States shall adopt the Directive no later than 4 years after the date of entry into force.<sup>1</sup>

In the framework of the Single Market (free movement of persons, services and capital), the EU has competence in respect of the regulation of certain aspects of pensions. Free movement of workers means that workers should preserve their rights when they move to another Member States. Regarding pensions, EU rules on social security coordination<sup>2</sup> ensure that a person’s insurance record is preserved in each country where they have worked or lived. Every country where they have been

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<sup>1</sup> <http://www.pensionseurope.eu/eu-pension-policy> (2016. 02.18.)

<sup>2</sup> Coordination of Social Security Systems in the European Union: An explanatory report on EC Regulation No 883/2004 and its Implementing Regulation No 987/2009, International Labour Organization 2010. 1. p

insured for at least one year will pay them an old-age pension when they reach that country's national pensionable age.

An Electronic Exchange of Social Security Information (EESSI) is being developed to help social security bodies across the EU to exchange information more rapidly and securely. To facilitate mobility vis-à-vis the rest of the world, the EU is also negotiating provisions on social security coordination with third countries.

Nevertheless, as regards supplementary pension schemes, obstacles to freedom of movement between Member States and to mobility within Member States remain. These obstacles relate to the conditions of acquisition of pension rights, the conditions of preservation of dormant pension rights and the transferability of acquired rights. After eight years of difficult negotiations,<sup>3</sup> a new directive on the acquisition and preservation of supplementary pension rights is due to be voted in plenary in April 2014.

To improve the pension rights of mobile workers, the proposed directive specifies that occupational pension rights must be granted after no later than three years of an employment relationship and puts forward rigid standards to ensure that the pension rights earned by outgoing workers continue to be preserved (e.g. indexed against inflation) when they move to another Member State. The directive would not however cover the portability of supplementary pensions. [1]

## THE AGEING AND THE FINANCIAL PROBLEMS

People aged 65 or over represent a significant and fast-growing share of the EU population<sup>4</sup>, particularly as the 'baby boom' cohorts reach retirement age and the number of prime working age people falls. Member States will have to adjust their pension schemes to three new major demographic parameters: the baby boom transition, often called the baby bust, rising longevity and declining fertility rates. In 2012, there were four people of working age (15-64 years old) for every EU citizen aged 65 years or over. By 2060, that ratio will drop to two to one. There will be more people of pension age and fewer workers to help support them.

The 2008 financial and economic crisis has worsened the impact of demographic ageing. While the crisis has affected pay-as-you-go<sup>5</sup> pension schemes through falling employment, and hence decreasing pension contributions, funded schemes were also hit by falling asset values and reduced returns. Many pension systems across the EU need some degree of adjustment in terms of adequacy and sustainability. Pension systems have to keep on delivering adequate pensions capable of preventing poverty and social exclusion amongst the older generations. They also have to meet the sustainability challenge. Pensions already represent a large share of EU public expenditure: 11.3% of gross domestic product (GDP) on

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<sup>3</sup> Occupational pensions; 'Second pillar' provision in the EU policy context, Library Briefing, Library of the European Parliament, Ron Davies, July 2013, 7 p. 5 Pensions Market in Focus, OECD, 2013, 64 p.

<sup>4</sup> 17.8% or 90 million in 2012.

<sup>5</sup> Pay-as-you-go (PAYG): Revenue from current contributions used directly to pay for current retirement benefits. Most public pension schemes are PAYG.

average in 2010, possibly rising to 12.9 % in 2060. <sup>6</sup> With spending on public pensions ranging from 7.5% of GDP in Ireland to 15.3% in Italy today, countries are in very different situations. [2]

The main responsibility for pensions remains with Member States (MS). However, the Treaty on the Functioning of the European Union<sup>7</sup> requires the EU to support and complement the activities of MS on social protection<sup>8</sup> and to take into account adequate social protection in defining and implementing its policies<sup>9</sup>. The 2012 White Paper<sup>10</sup> on pensions In May 2010, the European Parliament called for a more comprehensive approach to EU pension reforms.

The publication in summer 2010 of a European Commission (EC) Green Paper on pensions was a further initiative to launch debate on how and with which instruments the EU could best help MS to provide pensions for an ageing population. Coinciding with the 2012 European Year for Active Ageing and Intergenerational Solidarity, and in line with the Europe 2020 Strategy, the White Paper "An Agenda for Adequate, Safe and Sustainable Pensions" proposed a range of policy measures to balance time spent at work and retirement and to develop complementary private and retirement savings.

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<sup>6</sup> The Future of Retirement Pensions in the European Union, Foundation Robert Schuman, European issues n°282, 11 June 2013, 7 p.

<sup>7</sup> Treaty on the Functioning of the European Union in abbreviation: TFEU

<sup>8</sup> Article 153 TFEU

<sup>9</sup> Article 9 TFEU

<sup>10</sup> Following the White Paper on Pensions which came out in February 2012, the EC set up a Working Group on a code of good practice for occupational pension schemes. The purpose of such a code would be to improve the access to high quality occupational pension schemes and to raise their attractiveness. The Commission states that the added value of such a code would be to provide guidance and exchange of experiences from different countries. According to them the code could increase the transparency for beneficiaries and facilitate mutual recognition of schemes between countries.

The European Commission drafted a first list of elements for a code of good practice. The main elements are:

- Consistency
- Adequacy
- Safety
- Cost-Effectiveness
- Flexibility
- Transparency
- Governance

Those elements are currently being discussed with the aim of drafting a code. Pensions Europe is cooperating with the Commission, together with other stakeholders, to come up with a good result. There have been significant changes to occupational pension policy in some Member States of the CEE (Central and Eastern Europe) region currently. In this part of the Europe mandatory funded pension pillars have been established prior to the EU enlargement. The Member States were inspired for their pension reform by the World Bank model. In 2005 Pensions Europe established a CEEC Forum to promote the dialogue with the private pension industry in the CEE and the regular members of Pensions Europe in order to raise the concerns of the private pension sector in Brussels.

At the same time, the EU has reinforced its policy coordination as regards pension reforms through a new monitoring process and stronger coordination of structural policy reforms, which are closely connected.

The EC has launched a policy follow-up through monitoring and peer reviewing MS' pension's policies. In May 2012, the Economic Policy Committee and the Commission published the Ageing Report focusing on the results of the last decade of reforms, the impacts of the crisis and the long-term perspectives beyond the crisis (from 2010 until 2060).

In cooperation with the Social Protection Committee, the Commission presented the first Pension Adequacy Report (2010-50), showing that many reforms will result in lower statutory pensions in the future to ensure that public pensions remain affordable.

In the framework of the Europe 2020 strategy, the Commission has put on-line a thematic summary on the Adequacy and Sustainability of Pensions. The summary includes an overview of the key indicators of pension adequacy and sustainability in MS.

## RECOMMENDATIONS ON PENSIONS

With the Europe 2020 Strategy, and via the European Semester, both stronger coordination of national policies and a framework for examining pension systems have been established at EU level. The Semester process starts with the publication of the Annual Growth Survey by the EC, followed by the adoption of country-specific recommendations. The process aims to ensure that MS keep their budgetary and economic policies in line with their EU commitments (debt and deficit commitments under the Stability and Growth Pact, economic reform plans enshrined in the long-term growth and jobs targets in the Europe 2020 strategy).

In the first four Annual Growth Surveys (2011, 2012, 2013 and 2014), pensions are highlighted as a matter of increasing EU concern. The importance of preventing early exit from the labour market, removing fiscal disincentives to work for people of pensionable age, linking the age of pension entitlement to life expectancy, equalising the pensionable age between men and women, supporting the development of complementary private savings to enhance retirement incomes and addressing poverty risks for people in retirement are repeatedly flagged. Consequently, a majority of MS (from 15 to 17) have received country-specific recommendations related to their pensions' schemes within this period.

## MAIN ORIENTATIONS IN EUROPEAN PENSION POLICY

Two major policy orientations have emerged concerning the link between pensions and the labour market: balancing time spent in work and retirement, and reducing the gender "pension gap".

To sustain adequate pensions as people live longer, the duration of working lives has to grow, more or less in line with life expectancy. In 2012 and 2013, 17 and 15 Member States respectively received country-specific recommendations on pensions, which primarily focused on ensuring people work for longer. Following a range of pension reforms in recent years, 24 of the 28 MS (all except Belgium,

Luxembourg, Finland and Sweden) have now established current or future increases in pensionable age. Denmark, Greece, Italy, Cyprus, the Netherlands, Slovakia and the United Kingdom have decided to directly link pensionable age to life expectancy in the future. Finland and Sweden have introduced a flexible pensionable age, where the benefit level increases in case of later retirement. Despite the crisis, employment of older workers and effective exit ages have continued to grow or held up well in most MS. In 2012, the average annual employment rate of workers aged 55-64 in the EU was 48.8%, an improvement of 10 percentage points over the past decade.<sup>11</sup>

At the same time, significant cross-country differences remain (e.g. Sweden 73%; Germany 61.5%; Greece, Hungary, Malta, Poland, Croatia, Belgium and Slovenia below 40%). [3]

There is a marked gender divide in pension income, housing and financial wealth. Women are more exposed to the risk of poverty, since they start their retirement with lower pension entitlements and fewer resources but tend to live longer. Consequently, they suffer not only from a 'pay gap' and a 'promotion gap' but also from a 'pension gap'. In the EU-27, there is an estimated 39%<sup>12</sup> difference in men and women's income after the age of 65 (more than twice the figure of the 'pay gap', 16%). [4]

Member States are taking measures to guarantee gender equality in terms of pensionable age: 26 out of 28 Member States (all except Bulgaria and Romania) already apply the same pensionable ages to men and women or have passed legislation bringing in gradual equalisation in the future. Romania is also close to passing legislation to that end. This is in line with the EU policy to tackle gender discrimination.<sup>13</sup>

### *New rules on occupational pension funds*

Concerning financial governance of occupational pensions, Directive 2003/41/EC on the activities and supervision of Institutions for Occupational Retirement Provision (IORP) lays down basic requirements for occupational pension funds and their supervision, including rules which oblige occupational pension funds to invest their assets prudently, in the best interest of members and beneficiaries. However, there have been significant developments since 2003. First, the financial crisis has highlighted the need for sound governance of financial institutions and clear information to members and beneficiaries. In addition, ageing populations have increased the pensioner-to-worker ratio, and the need for more retirement savings and for strong occupational pensions systems. At last, there is increasing recognition of the need for long-term investment in Europe's economy, and occupational pension funds are among the largest institutional investors<sup>14</sup> in Europe. [5]

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<sup>11</sup> Employment trends and policies for older workers in the recession, European Foundation for the Improvement of Living and Working Conditions, 2012, 12 p

<sup>12</sup> The Gender Gap in Pensions in the EU, European Network of Expert on Gender Equality, Publications Office of the European Union, 2013, 100 p.

<sup>13</sup> Article 19 TFEU

<sup>14</sup> Pensions Market in Focus, OECD, 2013, 64 p.

In this perspective, on 27 March 2014, the European Commission adopted a legislative proposal for new rules on occupational pension funds. The proposal aims at improving governance and transparency of these funds in the EU, promoting cross-border activity, and helping long-term investment. More professional management of IORPs is expected to improve investment outcomes, thereby leading to higher pensions or lower contributions. Greater transparency should provide scheme members with better tools to take informed pension savings decisions early on in their working life. The proposal does not include a review of the existing quantitative solvency rules for occupational pension funds (the Solvency II Directive 2009/138/EC). Currently, the European Insurance and Occupational Pensions Authority (EIOPA) are carrying out detailed technical work on this issue. For now, no EC initiative is expected until the next European Commission takes office, according to Commissioner for Internal Market and Services Michel Barnier, speaking at the EC Conference on the future of pensions (Brussels, 26 March 2014).

### *Complementary retirement savings*

Recent pension reforms mean that most workers entering the labour market today will most probably get lower pensions than previous generations. Working longer may compensate for some of the reductions but overall, each year of contribution will pay out less than today (OECD). People will therefore also have to save more and governments have a role to play in the promotion of cost-effective instruments for retirement savings. In April 2013, the European Commission carried out a public consultation on consumer protection in 'third-pillar' retirement products, analysing possible measures for improving information and protection standards for consumers regarding 'third pillar' pensions. The EIOPA has recently submitted a report to the EC opening the possibility of creating a 'European retirement product' in the coming years.

### *Researches regard the pensions*

Many research institutes and international organisations share the same concern as regards the future of pension schemes in Europe. In its recent report, *The Inverting Pyramid*, the World Bank states that the deep effects of ageing populations and the shrinking labour force on overstretched state pension schemes demand significant reforms.<sup>15</sup> It concludes that public pension systems in Europe will have to prioritise the provision of basic pensions, coupled with measures to encourage longer working lives and individual savings. The OECD shows that recent reforms of pension systems have helped to contain the rise in future costs resulting from ageing populations and increasing life expectancy. It also underlines that funded pension programmes managed by the private sector<sup>6</sup> are likely to play an increasing role in delivering retirement income. Moreover, privately managed pension assets will

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<sup>15</sup> The inverting pyramid, *Pension Systems Facing Demographic Challenges in Europe and Central Asia*, The World Bank, February 2014, 32 p.

most probably play an increasing role in financial markets, notably as a source of long-term savings. The Robert Schuman Foundation highlights the fact that retirement systems in Europe still differ greatly in the way they function, and in terms of their financial situation, more than ten years after the introduction of the 'Open Coordination Method' in social policy that was supposed to launch a process of 'convergence'.<sup>[6]</sup>

## FINAL THOUGHTS

Although Member States have the primary responsibility for designing their pension systems, major demographic changes along with strong economic shocks make the case for updating the European Union's role as regards pensions. The European Commission's 2012 White Paper on pensions has been fundamental to this process. Describing how the European Union (EU) could best help Member States to provide pensions for an ageing population, it emphasises the need to address the objectives of adequacy, safety and sustainability together. It is plainly in line with the 'European Semester', the recently introduced process for monitoring economic policies and coordinating structural reforms in Member States. Via the White Paper and the new policy coordination mechanism, two major policy orientations have emerged: balancing time spent in work and retirement, and reducing the gender "pension gap". At the same time, securing both the safety and the sustainability of pensions are at the forefront of the European Union's agenda. In the context of free movement of persons, pension rights need to be secured to protect EU citizens from insufficient financial governance or accountability, in particular in respect of occupational pension funds. Complementary retirement savings might also be supported at European level in order to ensure sufficient pensions for the coming generations. This EU policy has given rise to extensive debate amongst stakeholders covering the issues of active ageing, gender gap, subsidiarity principle, financial sustainability, mobility of workers, etc. Nevertheless, broad consensus has arisen that in-depth reform of the retirement systems is needed everywhere in the EU.

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