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EDITORIAL

Bad news concerning the financial constraints of some pension schemes has held centre stage recently, unfortunately pushing positive news into the background. For example, it went almost unnoticed that the German civil servants pension scheme now rests on a solid financial base, following the reforms undertaken over the last few years. The forecast calculations in the 4th Federal Government report show that, despite a low birth rate and increased life expectancy, public budget expenditure for civil servant pensions will remain stable, expressed as a ratio of gross domestic product and of tax revenue, until 2050. In the long term, the ratio will even drop, even if the nominal expenditure increases. The downside is a lower level of pensions and a later retirement age. The report of the Federal Government shows that increasing numbers of Federal civil servants retire from active service after the age of 65.

Some public sector supplementary pension schemes can report that they have succeeded in overcoming the difficulties of the last year without excessive losses. Examples from Scandinavian countries, presented in this issue, show that schemes were able to avoid more serious problems thanks to a series of measures and to a cautious investment policy. The challenge, however, in particular for defined-benefit schemes, remains to ensure that guaranteed liabilities are covered and to achieve a smooth return to the pre-crisis situation.

Hagen Hügelschäffer
Original language: German

The German Civil Servants pension can still be financed

Pension financing remains a key issue

The consequences of demographic developments have a significant impact on public sector pension schemes. Reduced birth rates and increased life expectancy extend the duration of pension benefits, thereby increasing the burden on public budgets. In addition, there has been a significant increase in staff numbers following a broader scope of public service assignments during the 1960s and 70s and modified career developments. As from 1970, the change is extremely significant, with a marked increase in the proportion of top and higher-level civil servants. It is therefore to be expected that expenses will continue to increase, and that pensions will continue to be a hot topic in the long term.

Civil pension reports

Since 1989, German law requires the Federal Government to present a forecast report to the German Parliament concerning the evolution of the number of pensioners and of civil pension expenditure.

On October 17, 1996, the German Government published its first forecast report. For the first time, past and present public sector pension liabilities were described comprehensively, based on statistical data. Model calculations showed the development of civil pension expenditure until 2040.

The findings of the first report show a significant increase in the expenses of public sector pension schemes in the future.

The analysis was updated in September 2001 in the second forecast report, which included public sector pension expenditure data from the new Eastern German regions. A specific mortality table for civil servants was drawn up based on statistical investigations.

The third pension report, published in May 2005, continued the work of the second report, but also took into account the provisions of the law of December 19, 2000 on pension reductions in the event of early retirement and of the law of 2001 on civil pension reform, for the period from 2001 to 2003. Compared with the second report, the forecast period was extended by 10 years, until 2050. The forecasts were based on pensioner statistics as of January 1, 2003 established by the German Federal Statistics Office and on active civil servant statistics as of June 30, 2002. Owing to the moderated increase in pensions due to the law of 2001 on civil pension reform, the forecasts for 2040 were significantly lower than those in the previous report.

On April 8, 2009, the German Cabinet accepted the fourth forecast report. The report is confined to civil pension developments at federal level and no longer contains forecasts for the German regions and municipalities, given that different developments at national level and at local government level no longer allow an overall diagnosis.

In the meantime, some German regions have published their first forecast reports. The North Rhine Westphalia region has presented its 2nd forecast report and the Hamburg Senate has published a memorandum concerning the evolution of pension expenditure.

The significant results of the fourth pension report (Federal civil servants)

The steps taken by the German government have already made an impact. The percentage of early retirements has significantly dropped. Increasing numbers of civil servants leave active service only after reaching the pensionable age applicable to them (generally at the age of 65).

Since the beginning of the 1990s, statutory pension scheme reforms aimed at reducing the cost of pension benefits have been transposed to the public sector schemes, to achieve the same results. For

Federal civil servants, this has indeed led to a reduction in average pension levels. For civil servants and judges who retired in 2006, the average pension level is 3.4 % below the 1994 level.

Civil and military pension reform generated nominal savings of approximately 1.7 billion Euros between 1998 and 2006. Overall, pension expenditure dropped by approximately 7 % between 2003 and 2006. Since 2001, the number of pension beneficiaries has dropped overall. It will continue to drop by 45 % until 2050. The main explanation for this drop is the significant reduction in railway and post office staff.

Accompanying measures implemented by law

By means of the law of 1997 on civil service reform and the law of 1998 on public sector pension scheme reform, the German Parliament took measures to alleviate civil pension cost increases and to reduce the number of early retirements. All the reforms implemented in the statutory pension scheme since 1992 have been transposed into the civil servants pension scheme, with the same effects. Following the introduction of reduced pension levels in the event of early retirement, it is no longer possible for civil servants to retire before reaching the pensionable age without their pensions being affected financially.

The German state and the regions are now required to constitute reserve funds for the pensions of their civil servants. These funds are built up by means of lower increases in the salaries of active civil servants and in the pensions of retired civil servants. In the years between 1999 and 2013 (period later extended to 2017), civil servant salary and civil pension increases, that are normally indexed, will be 0.2 % lower on average than those of civil sector employees who are not civil servants. In the long term, the salary and pension level will drop by 3%. The law of 2001 on civil pension reform reduced the maximum pension level, from 75 % to 71.75 % of the last gross salary. The accrual rate was reduced from 1.875 % to 1.79375 %. Moreover, the survivor pension was reduced from 60 % to 55 %. Starting in 2003, the pension level will be reduced by 4.33 % overall, by means of eight identical steps corresponding to approximately 0.54 % each. All these measures will alleviate the burden of pensions on public budgets in the long term.

The law on special grants for Federal civil servants significantly reduced the annual grants (Christmas bonus and holiday bonus) paid to Federal civil

servants and pensioners as from 2004. Until 2003, all civil servants received a bonus at the middle of the year (holiday bonus) and at the end of the year (the so-called Christmas bonus). For Federal civil servants, the Christmas bonus was reduced from 8.33 % of the annual salary to 5 % in 2004, and to 2.5 % in 2007. The grant received by pensioners, that previously amounted to 4.17 % of their annual pension, was reduced to 2.085 % as from 2007. The German regions have also made use of this possibility of reducing special payments. All the new provisions concerning special grants represent a significant change compared with the previous situation.

Future prospects

Based on the calculations in the fourth forecast report on civil pensions, the nominal pension expenditure of the German State will increase in the years to come. Overall, the evolution should be stabilised.

The amount and the evolution of civil pension expenditure are not the most relevant indicators of the sustainability of a pension system. The decisive figures are the ratio between pension expenditure and the Gross Domestic Product, and the ratio between pension expenditure and tax revenue. The ratio between civil pension expenditure and the GDP is currently approximately 0.2 %. This figure will probably remain stable until 2045 and will then drop very slightly. The ratio between civil pension expenditure and tax revenue is currently approximately 2 %. A drop to approximately 1.8 % is expected between now and 2050. The share of civil pension expenditure compared with GDP and compared with future tax revenue of the German State will therefore not increase any more, but will, if anything, follow a downward trend.

It is therefore possible to relieve the burden on public budgets.

Gabriela Maria Graf, AKA
Original language: German

Feasibility study for a Pan-European pension fund now in progress

The reputed German weekly "Die Zeit" titled a recent article *"Mobility is penalized – if researchers relocate too often within Europe, their old-age pensions suffer. That is going to change"*. The background for the article was the European Commission call for tenders for a feasibility study concerning a Pan-European pension fund for researchers. A year ago, we already reported on a seminar within the framework of the Bologna Process, on the theme of pensions for mobile researchers (EPB, September 2008). Last November, the European Commission launched a call for tenders for a feasibility study concerning a Pan-European pension fund for researchers. The company Hewitt Associates has just been selected as the successful bidder.

Why Europe needs mobile researchers

One of the objectives of the Lisbon strategy is to make the European Union the most dynamic knowledge-based economy in the world by 2010. To achieve that objective, research institutions and universities need to attract the top international researchers and scientists. It is not enough, however, to hire highly qualified staff and to hold on to them as long as possible. It is important for the European Research Area and for research institutions to ensure exchange and mobility of scientists. Increased competition and limited public resources available for research in Europe call for greater efficiency, specialization and short-term planning in research. To achieve that, project-based work is a key tool. It is therefore not only desirable, but in fact necessary, to support the mobility of researchers between institutions and countries. Only then will Europe have a chance to assert itself as the most attractive economic area in the world.

It is therefore not surprising that the European Commission placed the working conditions and mobility of researchers in Europe high up on its agenda. As early as May 2008, the Commission published a communication identifying four priority starting points to improve the situation of mobile researchers (Brussels, 23/05/2008, SEC (2008)1911/1912). For the first time, the focus was not only on more attractive working conditions, better training for scientists and changes to the hiring process, but also on needs related to social security and supplementary pensions for researchers. For all the core issues, the Commission recommended targeted measures and initiatives achievable by a

European researchers' partnership. The key players are the member states of the European Union, with the Commission merely coordinating the process.

Plenty of homework for Member States

In September 2008, the member states adopted the initiative concerning a researchers partnership within the EU Competitiveness Council. They undertook to achieve visible progress in the four core areas by the end of 2010. It is now up to the individual states to analyse country-specific difficulties and to initiate improvement measures.

In Germany, the matter is being handled by the Federal Ministry of Education and Research, the competent ministers for the German Länder and the German Rectors' Conference (HRK). Concerning old-age pensions for researchers, one of the German specificities is that university professors and some other categories of scientific staff benefit from civil servant status. Following the latest reform of the German federal structure, each Land is now free to determine the salaries and pensions of its civil servants as it sees fit. This means that a mere relocation to another German region, not to mention another country, could have a significant impact on pension rights. For civil servant researchers, it will be difficult to change the legal framework of civil servant status in order to promote mobility.

It appears simpler to achieve improvements for scientists who are not civil servants, in particular those with fixed-term employment contracts. Their occupational pensions are managed by VBL, and VBL offers a solution that does not require a qualifying period, but to benefit from this solution, employees must be released from the statutory insurance obligation, and many people are not aware of this. Discussions between the HRK and VBL started last year, and in June of this year, they signed a joint statement on their future cooperation. Among the measures that can be implemented in the short term – and that are, in some cases, already implemented – there is, first and foremost, better information for researchers and training sessions for human resources departments. Moreover, the HRK suggested the creation of a network between pension institutions, higher education institutions, their administrative bodies and other stakeholders concerned, in order to achieve enhanced quality and greater efficiency in advising and informing mobile researchers.

Researcher mobility – a challenge for pension institutions as well

In the spring of 2009, the European Parliament approved the initiative concerning a European Researchers' Partnership. As previously mentioned, the European Commission will be coordinating the process. Several approaches are being implemented with respect to old-age pensions. Concerning coordination of social security matters, specific rules that already apply to cross-border mobility are to be extended and targeted at researchers. This would allow the situation to improve in the short term by using the existing legal framework. Scholarship holders should also benefit from better social security coverage.

Concerning supplementary pensions, the Commission is considering a Pan-European pension fund, where researchers would remain members throughout their careers, irrespective of the countries in which they work. Hence the need for an extensive feasibility study concerning this type of fund. Moreover, measures aimed at facilitating portability of supplementary pension rights for particularly mobile researchers need to be analysed.

Following a deliberation by the EAPSPI Board in January of this year, the Association contacted the "Research" department of the Commission through the German Rectors' Conference (HRK). In June, a first exchange took place between EAPSPI and the European Commission. Representatives of universities and staff from other Commission departments were also present. Mr Thiel presented EAPSPI, its members and its objectives. He explained the complexity and diversity of occupational pension schemes and the problems involved in the transfer of accrued pension rights or insurance, which have so far prevented the implementation of a European directive on portability. He emphasised that the first important thing to do is to ensure that mobile researchers do not lose pension rights following frequent job changes, owing to qualifying periods imposed by schemes. Concerning the possible creation of a Pan-European fund, he drew attention to the fact that increased costs are to be expected for the public authorities. He also emphasised that in some countries, such as Germany, for example, participation in a fund of this type would require a collective bargaining agreement.

To succeed, joint endeavours and cooperation are needed

Following the exchange of information, it was agreed that other possibilities for improvements for mobile researchers would be analysed, in particular with respect to better information for mobile employees and portability of rights. EAPSPI is considered to be an important partner in this process, because neither the Commission, nor the universities and research institutes, nor the pension institutions, are able to improve the situation of scientists by themselves.

The conclusions of the Bologna Seminar held in Berlin in 2008 already strongly emphasised this aspect: it is important to ensure dialogue among all the stakeholders. That is now done. EAPSPI is in a position to support this process and to serve as a contact with the Commission for its members who have scientists and researchers among their members. To continue the dialogue, the Board decided in June to include the theme of researcher mobility on the agenda of this year's conference in Berlin. Two presentations are scheduled. The European Commission will be represented, with a report on the status of the European Researchers' Partnership. After that, an HRK representative will clarify the problems researchers are facing and will present solution initiatives in Germany.

"Mobility without a net" is the title of a brochure recently published by the HRK. The brochure convincingly explains that it is precisely young researchers who will not be sufficiently covered for their old age, owing to their frequent job changes and to the lack of information. Of course, the onus is on universities and politicians to create a stable base for young researchers, but pension institutions can make a significant contribution by increasing awareness of the importance of pension planning among those concerned and by filling information gaps by means of more intensive communication. Moreover, pension institutions are genuinely competent and knowledgeable players when it comes to portability of pension rights.

The objective of the feasibility study is to neutrally analyse whether a Pan-European fund would be viable as an alternative form of pension. The study should analyse whether a new fund would increase the overall cost of pensions for employers. It is also important to establish whether this new offer would involve higher management costs for researchers, which would result in lower benefits for them after retirement. In that case, it may be more worthwhile for scientists and employers to remain within the

existing systems, provided that they improve portability and make it possible to avoid losing pension rights.

The costs of a Pan-European solution will certainly depend on the concept of the new fund. Very different forms are possible. It is not really necessary to transfer the management of assets of the different national sections to the fund. One could also imagine a "virtual pooling of assets", or other systems where assets would remain in the local funds. Given the host of possibilities, one can be curious as to what type of Pan-European fund the feasibility study will focus on.

Claudia Wegner-Wahnschaffe, VBL
Original language: German

Social Europe and competition law

Introduction

One of the challenges for Europe is to strike a balance between the principle of free competition and a social Europe. The European Commission investigation into the alleged existence of institutional liability in favour of public sector supplementary pension institutions (SPI) falls within the scope of these two concepts. At the end of its investigation, the Commission ascertained in May of this year that there is no unlawful state aid in the form of an unwritten institutional liability for public sector supplementary pension institutions in Germany. To ensure public transparency, the supplementary pension institutions concerned have since clarified and publicised this matter.

The positions expressed reveal not only a different interpretation of European law (in particular the definition of the term undertaking used in Article 87, paragraph 1 of the EC Treaty), but also the significance granted to the case law of the highest courts of Member States in European law.

Background

In Germany, public sector supplementary pensions are governed by a collective agreement. This means that the social partners in the public service determine the form and organisation of public sector employee pensions by means of a collective agreement. Supplementary pension institutions are bound by the provisions of collective agreements. The onus is on

them to implement the collective agreement concerning occupational pensions for public sector employees in Germany. Supplementary Pension Institutions are organised in the legal form either of public law special assets, or of public law bodies and institutions.

In 2001, the social partners in the German public sector agreed that supplementary pension institutions should offer their members the possibility of voluntary insurance financed by employee contributions. Above and beyond the already existing compulsory membership of a supplementary pension institution, financed mostly by public sector employer contributions, employees also have the possibility of building up their own occupational pension. This voluntary additional membership of the supplementary pension institution is designed as a subsidiary product to the compulsory insurance and is therefore open only to public sector employees.

Contrary to other member states, German law recognises the legal institution of institutional liability (Anstaltslast). This is a sort of contingent liability of the State in case of need, given that the authority responsible for a public-law institution is required to secure the economic basis of the institution and to ensure that it remains operational. According to the case law of the highest courts (see below), a legal basis is required for the state guarantee, ordering institutional liability. In the legal framework of supplementary pension institutions (legal texts creating such institutions, articles of association), this type of institutional liability or guarantor liability was not set forth, and is still not provided for today.

Positions

Contrary to the case law of the highest German courts, the European Commission initially considered that for institutional liability to exist, it was not necessary that it be normalised in legislation, but could exist as an unwritten legal principle. The Commission considered that unwritten institutional liability of this type amounted to unlawful state aid to supplementary pension institutions. In order to exclude any unlawful state aid, it considered that the legal texts governing the supplementary pension institutions concerned would have to include a specific statement indicating the absence of institutional liability. Moreover, the European Commission considered that supplementary pension institutions were unlawfully “cross-selling” by offering voluntary insurance financed by employee contributions. The term “cross-selling” refers to the sale of several products or services to the same clientele. Owing to their direct and

exclusive access to customers, namely public sector employees insured as compulsory members, the voluntary insurance products of supplementary pension institutions were considered to constitute cross-selling.

The viewpoint of supplementary pension institutions is that there is no unlawful state aid, because an SPI is not an undertaking as understood by European competition rules (art. 87, par. 1 of the EC Treaty). Given that the supplementary pension institutions are required to implement the provisions of a collective agreement only, they have no leeway in the design of their product offering and therefore do not benefit from the decision-making autonomy of an entrepreneur.

Supplementary pension institutions have also rejected the allegation of cross-selling between compulsory insurance and voluntary insurance. Thinking logically, cross-selling presupposes marketing two different products, that are offered together as a single package. Public sector occupational pension, however, is a comprehensive product, consisting of a basic component (compulsory insurance) and a subsidiary component (voluntary supplementary insurance).

Moreover, institutional liability is not legally normalised for supplementary pension schemes. The existence of an unwritten legal concept of institutional liability cannot be confirmed, even more so given that the highest German court in administrative matters, the Federal Administrative Court, stated in two rulings (3C 1/81 and 3 C 3/91) that legal codification is a prerequisite for the existence of such a liability.

Based on this case law from the highest German court, the European Commission subsequently reconsidered its initial position according to which the voluntary insurance offering of supplementary pension institutions benefited from an unwritten legal principle concerning institutional liability.

Analysis

The European Commission approach, according to which supplementary pension institutions benefit from unlawful state aid as understood by Art. 87, par. 1 of the EC Treaty, was rightly contradicted by several points.

- From the German point of view the fact was rightly emphasised that supplementary pension institutions are not undertakings as understood in Art. 87, par. 1 of the EC Treaty,

operating as competitors on the private insurance market. Supplementary pension institutions do not correspond to the European definition of a competitive undertaking. They act only within the strict and normalised framework of a closed system, governed by a collective agreement. The ECJ does not recognise the characteristics of an undertaking if the entity concerned does not have the possibility to make decisions freely and if its actions are predetermined by imposed conditions, such as a collective agreement (ECJ, case C-205/03 P, Fenin, col. 2006, I-6295). The ECJ thereby confirmed its holistic view of solidarity-based pension schemes: if their activities, that have an economic and entrepreneurial nature when considered individually, serve a pension system with a comprehensive solidarity-based approach, then the institution as a whole does not have the characteristics of an undertaking.

- Moreover, Germany rightly defended its viewpoint concerning the cross-selling issue: compulsory insurance and voluntary supplementary insurance are not two different products, but a unitary product. The basic component, compulsory insurance, is complemented by the subsidiary product, "voluntary supplementary insurance". Cross-selling, on the other hand, requires the sale of an additional product following the sale of the actual product. Cross-selling is widespread in private insurance, where companies analyse customer data to extract target groups for new insurance products.
- The viewpoint according to which institutional liability existed by virtue of an unwritten legal principle was rightly abandoned. Not only do the rulings of the Federal Administrative Court specifically require legal codification, but the Federal Constitutional Court, the highest court and also a constitutional body of the Federal Republic of Germany, confirmed the ruling of the Federal Administrative Court in its ruling 1 BvR 227/82. It was therefore stated, in a final ruling, that institutional liability must be legally codified by a Federal law, by a law passed in one of the German *Länder*, or by decree. Interpretation of European law cannot override this national case law. Given that the legal texts of supplementary pension institutions do not contain a legal regulation with respect to in-

stitutional liability, they cannot benefit from institutional liability.

The parallel drawn by the European Commission between this issue and the procedure against the Federal Republic of Germany for State guarantees in favour of public credit institutions (Commission decision of March 27, 2002, E 10/2000) is not conclusive. At the time, the European Commission also criticised unlawful state aid in the form of institutional liability for the central banks of the German *Länder*. Contrary to the legal texts governing supplementary pension institutions, however, the institutional liability for central banks in *Länder* was explicitly normalised in their establishment laws. It is for that reason only that the Federal Republic of Germany committed itself, following procedure E 10/2000, to cancel the legal provisions guaranteeing an institutional liability to the central banks of *Länder*.

- Initially, it was favoured including a specific statement of absence of institutional liability in the legal texts establishing supplementary pension institutions, but this would have led to far-reaching changes in the legal system of the Federal Republic of Germany. The case law of the highest court, i.e. "no institutional liability based on unwritten customary law" would have been reversed to say the contrary. The result would have been that all of a sudden all public law institutions in Germany, from municipal swimming pools to universities via hospitals, would have benefited from unwritten institutional liability and therefore from unlawful state aid. It would then have been necessary to include, in all the legal texts of all public law institutions in Germany, the wording initially required by the European Commission, stating that there is no unwritten institutional liability.

Conclusion

Closer examination of the public sector supplementary pension system in Germany has shown that the initial suspicion of unlawful state aid is unfounded.

The procedure discussed here shows the conflict between national case law and its interpretation by the European Commission. It shows, in terms of interpretation of national law, the significance initially granted to the case law of the highest courts of a member state. In questioning the case law of the

highest courts of a member state in the interpretation of its national law, the European Commission would have overstepped the bounds of its competencies as the guardian of community law (Art. 211 of the EC Treaty).

The European Union must strike a balance between a social Europe and free competition. In defining the term "undertaking" as understood by Art. 87 par. 1 of the EC Treaty in the Fenin case (col. 2006, I-6295), the ECJ provides an important contribution. With its definition focused on functions, the Court reinforces the position of solidarity-based pension schemes, thereby reinforcing the position of social Europe. Social policy should not be disregarded when applying European law on state aid.

Georg von Hinüber, AKA
Original language: German

Occupational pension schemes implemented by collective agreements and their advantages

Introduction

"Our pensions are secure!" With those words, former German Labour Minister Norbert Blüm stated in the 1980s that Germans could rely on the statutory pension scheme to maintain their standard of living after retirement. As a matter of fact, the average net pension level of employees who had contributed for 45 years was still approximately 70 % of their former salary at the beginning of the 1990s, which made the German statutory scheme rather generous at the time, even by European standards. But the reforms voted over the last ten years will lead to a significant drop in first-pillar pension benefits. Experts forecast an average pension level of only 43 % in 2030, meaning that, generally speaking, the statutory scheme will no longer be sufficient to maintain the usual standard of living. To avoid impoverishment in old age, it has become essential to reinforce supplementary pensions, whether within the framework of the second or the third pillar. In this respect, the German pension system will be increasingly like the structure of systems in the Scandinavian countries, the Netherlands, Switzerland, Great Britain or Ireland, namely a basic pension from the statutory scheme and supplementary benefits from the second or third pillar to maintain a constant standard of living.

To achieve such a fundamental reorganisation of the pension system, even with long-term planning, it is essential that as many people as possible have access to a supplementary pension scheme, so that first-pillar cuts are absorbed to the greatest possible extent. Moreover, covering a great number of people offers the advantage of reduced internal costs, so that future beneficiaries have higher benefits. Comprehensive coverage by supplementary pension schemes can be obtained in two ways: either by means of a legal obligation, or by means of collective legal solutions, namely collective agreements.

Collective agreements as supplementary social protection

There are many examples of supplementary social protection governed by collective agreements in other European countries. In France, for example, supplementary health insurance is the subject of collective agreements. Holiday funds negotiated by collective agreements are widespread in Austria, Germany, Great Britain and Italy, for example. In Finland, the social partners regulated supplementary unemployment benefits and the prevention of occupational accidents by means of a collective agreement. In view of first-pillar benefit cuts in many countries, occupational pension schemes negotiated by collective agreements play an important role in many European countries. Their structures, similarities and advantages will be presented in this article.

The development of occupational pensions in Europe

A look at a map shows that occupational pensions in general and solutions by collective agreements in particular are mostly present in Northern and Western Europe. According to a European Commission survey in 2005, approximately 94 % of people working in the Netherlands have accrued future occupational pension rights. The level was 75 % in Sweden and 68 % in Denmark. The German figure was 57 %, but this has constantly increased in recent years, in particular since the beginning of the decade, owing to the promotion of occupational pensions as compensation for first-pillar cuts. On the other hand, there are countries, mostly in Southern Europe, where occupational pension schemes play a very secondary role. In 2005, the occupational pension development rate was only 12 % in Spain, only 4.3 % in Italy and only 4 % in Portugal. As for most countries in Central and Eastern Europe, they have even lower occupational pension levels.

These differences within Europe can be explained by the importance of the first pillar in each member state. The development of occupational pension schemes is directly linked to the level of average benefits from the statutory scheme. The average gross figure for the first pillar is only 30 % in the Netherlands, the leader in the occupational pension category, 45 % in Denmark and 53 % in Sweden. On the other hand, the figures are over 90 % in Spain, 79 % in Italy and 75 % in Portugal. These figures explain why there is no need to create widespread coverage by occupational pension schemes in these countries, as first-pillar benefits are still sufficient to maintain the standard of living. Spain is an exception, because despite generous first-pillar benefits, occupational pension schemes are gradually gaining ground, in Basque country in particular.

The situation in Central and Eastern Europe is specific. With a few exceptions, occupational pension schemes are almost unknown, not to mention collective bargaining solutions. This is due to the fact that most of these countries have not opted for the classic "three-pillar" model, but have based their pension systems on the World Bank model. According to this model, above and beyond a first pillar financed on a pay-as-you-go basis, there is an additional contribution that is also compulsory, but funded, considered as a second layer of the first pillar. Generally speaking, there is no room left for occupational pension schemes, given that the two layers of the first pillar serve the same purpose as the first and second pillars, in the usual sense of the terms.

This article will therefore focus mostly on occupational pension schemes governed by collective agreements in countries where they are the most widespread, namely in Scandinavia, the Netherlands and Germany. For our practical examples, we will focus on public sector occupational pension schemes negotiated by collective agreements. Despite the differences in the structures of old-age pension systems in the different countries, these schemes show a number of similarities and advantages.

Public sector occupational pension schemes governed by collective agreements

The first thing all public sector occupational pension schemes governed by collective agreements have in common is the fact that they cover almost all employees and therefore contribute to large-scale protection, which is the objective. Given the significant staff numbers in the public sector, the consequence is that a large proportion of employees in a given

country accrue occupational pension rights. In Scandinavia, the Netherlands and Germany, approximately 10 % of the total population is covered, and sometimes even more, either by receiving benefits from public law supplementary pension schemes or by accruing rights as an active employee.

Moreover, the level of benefits is generally higher than that of other private sector schemes. This is because, contrary to pension plans, public sector occupational pension schemes governed by collective agreements in the Netherlands, Norway, Germany and the United Kingdom are always defined-benefit schemes (DB-schemes), whereas otherwise defined-contribution schemes (DC-schemes) are increasingly the norm, the latter generally offering a lower average pension level. The Swedish situation is specific in that defined-contribution schemes are widespread. The social partners in the Swedish public sector agreed on a "mixed scheme", in which employees are members of a defined-contribution occupational pension scheme up to an annual income of approximately € 34,000, and beyond that income figure, they benefit from a defined-benefit scheme.

When it comes to financing, funded systems apply in most countries. Financing on a pay-as-you-go basis for the second pillar is even forbidden by law in the Netherlands and in Spain. The developments in public sector supplementary pensions in Germany are noteworthy. Generally, schemes were financed on a pay-as-you-go basis until the system was reformed, with effect as from December 31, 2000. Within the framework of this change from a top-up scheme, with benefits based on the last salary, to a points system, some supplementary pension schemes changed their financing process. For the church supplementary pension funds, the change was significant given that, thanks to their astute financial policy in the past, they were immediately able to implement a funded system, also including the pensions to be paid and the rights already accrued. Other local supplementary pension schemes, in particular in East Germany, will follow in the medium term.

In most European countries, public sector supplementary pensions governed by collective agreements are managed by second-pillar institutions. In the Scandinavian countries, these institutions mostly belong to insurance companies and should therefore be considered as belonging to the third pillar, from an organisational viewpoint. At European level, these differences in organisation were clearly revealed when it came to establishing whether the provisions of Solvency II should also be applied to second-pillar institutions, or whether the second and third pillars

are so fundamentally different that Solvency II cannot apply to occupational pension institutions.

The advantages of solutions governed by collective agreements

Supplementary pension schemes governed by collective agreements offer a number of advantages compared with other solutions. These advantages include comparatively low costs and, therefore, great efficiency, in particular due to the fact that almost all the employees in a given sector are covered. This efficiency was emphasized by the Social Protection Committee (SPC) of the Commission in its 2008 study: "Privately managed funded pension provisions and their contribution to adequate and sustainable pensions". A Dutch survey conducted in 2007, entitled "Costs and Benefits of Collective Pension Systems" (published by *Steenbeck/van der Lecq*) confirms this observation. For example, the annual management costs of occupational pension institutions drop disproportionately to the increase in the number of members. If the internal cost per year and per member is 156 Euros for 1,000 to 10,000 members, it drops to 86 Euros for 10,000 to 100,000 members. For large groups of up to 1,000,000 members, the cost even drops to only 28 Euros a year (*Steenbeck/van der Lecq*, p. 55).

It is also very interesting to compare the management costs of occupational pension institutions with those of life insurance companies. The table below on the ratio between management costs and contributions, based on total capital investment volumes, shows that second-pillar occupational pension institutions achieve lower costs in all cases.

The first explanation for these differences is the large number of members, which is the consequence of an obligation created by a collective agreement. Moreover, second-pillar institutions do not have any costs related to marketing and sales forces. Concerning pension products offered by insurance companies,

the effects of selection are frequently observed, following the right granted to the insured to opt for payment of a lump sum at the beginning of the retirement period. Finally, occupational pension institutions do not have to distribute profits (in part or in full) to shareholders or partners, which means that their insured members benefit.

Another advantage of collective systems lies in the membership of their controlling bodies, with equal representation of employers and employees, thereby guaranteeing fair representation of the interests of all the parties concerned. This is how public sector supplementary pension schemes are organized in Norway, Sweden, Denmark, the Netherlands, Germany and Spain. Finally, in the event of disputes, occupational pension schemes governed by collective agreements occupy a special position in some countries. In Sweden and Germany, there are public-law arbitration courts that settle disputes at a lower cost and in many cases faster than ordinary courts. Based on case law from the highest German courts, the social partners even have greater leeway when it comes to indexing occupational pension plans, compared with individual or corporate solutions. In the statement of grounds, case law refers to the equal representation of employers and trade unions, guaranteeing that employee interests are sufficiently preserved.

Specificities at European level

The specificities of collective solutions are recognized not only within different member states, but also by EU Law. The special role and responsibility of social partners in the organisation of supplementary social protection are, for example, mentioned in paragraph 139 of the EC Treaty. The Treaty provides that dialogue between social partners at European level can lead to an agreement. The agreement will then be implemented either according to the procedures and customs of the social partners and member states, or, at their joint request, by a decision of

Ratio between management costs and contributions of life insurance companies and of occupational pension institutions, based on capital investment volumes

Total amount of capital invested	Life insurance companies	Occupational pension institutions
10 - 100 Million €	36.1 %	7.8 %
100 – 1,000 Million €	17.2 %	5.0 %
1,000 – 10,000 Million Euros	13.2 %	3.9 %

Source: *Steenbeck/van der Lecq*, Costs and Benefits of Collective Pension Systems, p. 64

the Council, following a proposal from the Commission.

The drafting of the so-called "portability" directive is an example for the involvement of social partners in the framework of EU legislation, even if the prior dialogue between employers and employees did not lead to the desired consensus and the Commission therefore took up the issue as the theme of a draft directive. The idea was to regulate the portability of accrued supplementary pension rights, as well as the accrual and preservation of dormant rights. Prior to publication of the first draft in October 2005, the Commission consulted the social partners twice. During the first consultation, the discussion focused mostly on the expediency and possible focus of a European regulation on portability. At that stage, there was still agreement among the social partners. During the second consultation, when it came to determining the content of a European regulation, the social partners were no longer able to come to an agreement. Notwithstanding these different views, the Commission continued to focus on granting an important role to social partners in its draft directive, as shown by the fact that the Commission planned to entrust subsequent transposition into national law not only to member states, but also to social partners, by means of collective agreements. In the revised draft of October 2007, the Commission even allowed social partners greater leeway, granting them the possibility of negotiating clauses that differ from the key material provisions of the future directive concerning the accrual and preservation of dormant rights, provided that such clauses guarantee equivalent social protection overall.

The case law of the European Court of Justice has also constantly taken the specificities of occupational pension schemes governed by collective agreements into consideration. In the "Albany", "Brentjens" and "Maatschappij Drijvende Bokken" cases (C-67/96, C-115/97 and C-219/97), the Court clarified the relationship between freedom of collective bargaining and competition law. The Court was asked to rule on the issue of forced membership of employers in an occupational pension fund in the Netherlands. In its decision, the Court recognised an exception to competition law, in favour of collective agreements, and emphasised that the onus is on the Commission to promote close cooperation between member states, in particular with respect to right of association and to collective agreements between employers and employees, in order to achieve the social policy set forth in the EC Treaty. For that reason, collective agreements do not fall within the scope of article 85, par. 1 of the EC Treaty. This case law was confirmed by

the ECJ in its "Henrik van der Woude" ruling (C-222/98). This ruling states that clauses in a collective agreement concerning supplementary health insurance are compatible with Community law. In this case, the collective agreement provided that the part of the insurance premium to be paid by the employer could be paid only to the insurance company stipulated in the collective agreement. In this ruling also, the freedom of the social partners to autonomously negotiate working conditions by means of a collective agreement was a decisive factor.

It now remains to be seen whether the specificities of occupational pension schemes governed by collective agreements will continue to be taken into account in community law. The uncertainty concerns future developments in secondary legislation, but, above all, the current considerations of the Commission concerning solvency rules applying uniformly to occupational pension institutions throughout Europe. The above explanations show that occupational pension schemes governed by collective agreements have a number of specific features that differ from the offers of life insurance companies, making additional safety mechanisms superfluous. We need to observe not only the developments within the Commission, but also the future case law of the ECJ. An infringement procedure against the Federal Republic of Germany (C-271/08) is currently pending, concerning a collective agreement pertaining to deferred compensation. Like in the "Hendrik van der Woude" case mentioned earlier, this collective agreement provides that deferred compensation, i.e. voluntary conversion of part of the salary into occupational pension rights of equivalent value, can be managed only by specific pension institutions named in the collective agreement (see EPB no. 27, p. 9, for more details).

Conclusions

Supplementary pension schemes governed by collective agreements have become an important part of old-age pension planning in Europe and will continue to gain ground owing to the drop in first-pillar benefits observed in many countries. In many aspects, these schemes are different from the solutions offered by the third pillar, as recognised not only within the different member states, but also at European level. One can only hope that the Commission and the European Court of Justice will continue to take the specificities of these schemes into account, as they have in the past.

In all countries, supplementary pension schemes negotiated by the social partners cover a great num-

ber of employees, have managed occupational pensions efficiently for many years and even decades, and offer insured employees a high level of benefits for a relatively low cost. In view of the debate underway in some countries concerning the implementation of compulsory supplementary protection for all employees, one might be tempted to say that the goal would be easier to achieve by promoting occupational pension schemes governed by collective agreements. Social partners are more familiar with the situation and specificities of their professional branches than lawmakers. They will be able to negotiate fair and well-adapted social protection for the employees in their branches and, as required, react more quickly to change.

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Original language: German

Collective pension schemes and the financial crisis - the Scandinavian perspective

Summary of a presentation to the annual aba Conference in Stuttgart on May 14, 2009

In principle, the global financial crisis is a bank problem, that also has indirect effects on the financing of pension insurance. To understand the background of the crisis, one needs to know where and how capital flows around the world. The USA imports about 60 percent of capital volumes and borrowing has significantly increased since the beginning of the new millennium.

A look at annual home pricing trends in the USA ("Case-Shiller Index") shows how the financial crisis arose. This index has dropped significantly since 2007.

We should have felt the global effects of a crisis way before September 2008. The unemployment rate in the OECD countries increased to 7 %; the return on the 10-year Government bond in the USA and in the EU countries dropped to less than 3 % and the prime rates of Western central banks even dropped to less than 1 %. In a short period of time, the "3-month interbank credit spread" increased by over 200 basis points against the prime rate (and even 300 points in the United States) and 5-year Government bonds in some EU member states, such as Greece and Ireland, were 2 to 2.5 percentage points above German Federal bonds in the spring of 2009. Almost everywhere, banks needed equity contributions and bene-

fited, amongst other things, from Government bailout packages.

In Norway, the prime rate dropped to 1.5 % and for a pension insurer such as KLP, the greatest challenge is the following: how, in such circumstances, can a guaranteed rate of return of over 3 % be achieved?

The KLP mutual life insurance company was founded in 1949 to offer supplementary pension products to the Norwegian public sector. Insurance contributions paid in 2008 amounted to approximately 22 billion NOK (about 2.25 billion Euros) and the balance sheet as of December 31st showed assets of 202 billion NOK (about 23.5 billion Euros). Schemes governed by collective agreements are 100 % defined-benefit schemes: a so-called "gross pension", with an annual guaranteed return rate, both on funded pension plans and on accrued pension rights.

The macro-economic situation has not evolved in the same way in the different Scandinavian countries. At the beginning of May 2009, the key figures showed 0 % inflation in Sweden, but 2.5 % in Norway. The unemployment rate, however, was significantly higher in Sweden than in Denmark and Norway. The Swedish Central Bank even dropped its prime rate to a historic low of 0.5 %. Norway achieved a much higher gross domestic production, but, like Sweden, had to face a devaluation of the national currency of up to 10 %, against the Euro and the Dollar. All the Scandinavian stock exchanges held up well in the first four months of 2009, with indices even increasing 20 to 25 %, while other indices such as the Dow Jones, CAC, FTSE and DAX were sometimes in the red.

In Scandinavia, supplementary pension schemes managed by collective agreements are not subject to the same conditions in all countries. In Norway, there is a single defined-benefit product, that is fully funded. In Denmark, there are mostly defined-contribution schemes and combinations between different products. Sweden offers both defined-benefit and defined-contribution schemes. Against the financial crisis, the measures implemented by Scandinavian pension institutions have one thing in common: the reduced proportion of shares in the assets managed, with a greater withdrawal from global markets than from the Scandinavian market (like Nordic portfolio). Other measures against the financial crisis included financial instruments, derivatives and hedge programmes. At KLP, the CPPI-System ("Constant Proportion Portfolio Insurance") is used. In 2008, the "value-adjusted return to liabilities"

ratio triggered ten "sale" signals and three "purchase" signals.

The special measures implemented in Denmark include relief for mortgage-bond holders, and in Norway, the National Bank offers exchange of debenture loans. Swedish pension insurers calculate their pension liabilities, in particular those with guaranteed returns, against an interest curve and no longer against a point. In Denmark, pension insurers are considering implementing a so-called "rate protection" against client mobility; a drop in maximum return rates is also observed.

In Denmark, the Government guarantees *all* bank deposits. Norway applies a legal limit of 2 million NOK (currently 230,000 Euros). The Swedish Government increased the limit to 500,000 SEK (almost 50,000 Euros). All the Governments have made bail out packages available to banks. The Norwegian programmes are the most ambitious and include help to save Iceland.

What is the capital investment breakdown at KLP? In 2008, guaranteed return rates were covered partially by using additional reserves. This provoked low solvency and consequently a search for "secure" investments. At the end of 2008, the breakdown of the KLP portfolio was as follows: real estate: 11 %; term bonds: 36 %; loans: 11 %; shares: 6 %; bond loans: 22 %; money market: 14 %. The gross result was positive for 2008, with a return of 1 %, for an annual result of +397 million NOK (approximately 46.13 million Euros). The value-adjusted returns, including term bonds, on the other hand, reached minus 1.7 %.

For 2009, financial developments so far show that there is no funding gap concerning pension liabilities in Norway and that occupational pension schemes governed by collective agreements have done a good job managing the financial crisis.

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