Europe and pensions: confronting risks and policies

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abstract

This paper examines the European variety in pension structures and reforms. The European Member States deal with the same pension risks in very different legal ways. Economically and sociologically it is commonly believed that there is a common European pension policy. Economically this can be explained because of the economic basis of the European Union. Economists tend to analyse the pension issues on the basis of some common economic parameters such as economic risks. Sociologists tend even to refer to the so-called “European Social Model”. From a legal perspective both the economic and sociological analysis’s are to be questioned. The legal differences in pension systems remain and even become wider. There is no coherence between the different research options. It is clear that a more coordinated research should be undertaken.
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table of contents

1. Risks ........................................................................................................................................... 3
2. Reforms and risk transfers ........................................................................................................ 8
   1. National reforms .................................................................................................................. 8
   2. European pension policy ...................................................................................................... 15
   3. Economic similarities without legal background .................................................................. 20
3. Risks and reforms: legal variety ............................................................................................ 22
   1. The acquisition condition of a pension ............................................................................... 24
   2. The calculation method ........................................................................................................ 24
   3. The affiliation rules ............................................................................................................. 26
   4. The level of organisation ..................................................................................................... 27
   5. The various actors interfering in the pension scheme ..................................................... 28
   6. The booking of the pension scheme ................................................................................... 28
   7. The coverage rate of the schemes ....................................................................................... 29
   8. The fiscal treatment ............................................................................................................ 29
   9. The control mechanisms of the pension schemes ............................................................ 30
  10. The participation levels ......................................................................................................... 31
  11. The cost bearing of the scheme .......................................................................................... 31
  12. Methods of financing ......................................................................................................... 32
  13. The role of the government ................................................................................................ 33
4. An enormous legal patchwork .................................................................................................. 33
Conclusion: no common European legal pension basis ............................................................ 35
1. Risks

Risks. All pensions schemes contain various risks. These risks are well known. They have been described many times. Academics have discussed in length their interdependence and their impact on an ageing society. Various theoretical explanations exist on all these interlinked risks. It is also known that these risks are not always linked to a specific pension pillar or financing technique.

Listings. There are several lists of the risks existing with regard to pension systems. Most of these lists have an economic or sociological background. In various forms and with various explanations the following risks are most commonly known:

1. the demographic risk;
2. the economic risk;
3. the company insolvency risk;
4. the risk of fraud;
5. the political risk;
6. the individual risk.

Each such catalogue of pension risks is somewhat artificial. First, the risks are all linked to one another. Secondly, various authors have other priorities regarding the analysis of these risks and make a different catalogue. For the purpose of this paper it is sufficient to enumerate the risks and give a short description.

1. The demographic risk. The demographic risk basically contains two elements: uncertain fertility and uncertain longevity. Both elements have an incidence on both PAYG pension schemes or funded pension schemes. The most important consequence of the uncertain fertility ratio is the cohort size. This uncertainty leads to wanted or unwanted transfers between (age) cohorts. The most important consequence of the uncertain longevity is the underestimating of the amount needed as a retirement income. For state based pension schemes the longevity risk in a PAYG scheme means that the state budget will be used as a buffer or that extra reserves will need to be accumulated. For companies (in general, not only insurance

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2 N.M. STOLEN, How to prevent increased pension expenditures in a DB system when Life expectancy improves, FINANCIEEL FORUM-BANK en FINANCIEWEZEN, BRUSSELS, 2007/2, 98-105.
companies) the longevity risks means that the pension guarantee is a burdensome financial risk\(^3\). This burden is commonly shifted to the individual after a while (e.g. the worldwide shift from DB to DC plans). For the individual the uncertain life expectancy after retirement leads to the individual chance of outliving the accumulated assets. The demographic risk as a whole has mainly lead to a downward pressure on defined pension benefits\(^4\).

2. The economic risk. The economic risk with regard to pensions contains many elements and many stakeholders are involved. For this paper, an enumeration of these risks is sufficient.
   - Uncertain productivity growth (for both PAYG and funded schemes).
   - Inflation whereby the pension wealth may be insufficiently protected from price instability. The real value or purchasing power of retirement incomes may decline.
   - Inadequate funding leading to uncertain asset values due to:
     - Uncertain investment returns due to:
       - the failure of wise investment\(^5\) such as the lack of diversification (Employer stock) or overly conservative investments;
       - lack of investment expertise or lack of professional advice;
       - lack of market transparency leading to wrong decisions and excessive (undisclosed) fees.
     - Uncertain liquidity
   - Excessive minimum capital requirements for investment opportunities
   - Economic intransparency often leading to a lack of legitimacy
   - The possibility of oligopolies or even monopolies in some pension markets (e.g. the reinsurance market in Europe)

Together with the demographic risk the economic risk is widely examined and analysed. However the other risks are clearly as important although less studied.


\(^4\) Europe is facing today unprecedented demographic change. In 2003, the natural population increase in Europe was just 0.04% per annum; the new Member States, with the exception of Cyprus and Malta, all saw falling populations. In many countries, immigration has become vital to ensure population growth. The fertility rate everywhere is below the threshold needed to renew the population (around 2.1 children per woman), and has even fallen below 1.5 children per woman in many Member States. For more details see: COMMISSION OF THE EUROPEAN COMMUNITIES, Green Paper “Confronting demographic change: a new solidarity between the generations”, Brussels, 16.3.2005, COM(2005) 94 final, 27 p.
3. The company insolvency risk. Closely linked to the economic risk as a whole is the risk a company can go bankrupt. Not only an employer but also a pension fund, an insurance company or a bank can simply go bust. Insolvency can lead to a downfall in the pensioners right. Because of this risk a lot of countries have taken protective measures. There are mainly four options:
- limiting the amount of company stock within the pension scheme;
- limiting the possibility of internal booking of pensions debts within a company (e.g. book reserves) whereby the pension is created and upheld within one and the same company;
- enforcing the externalisation of pension money by obliging employers to contract with pension funds or insurance companies;
- creating strict funding rules whereby the property of the pension money is transferred to the individual employee.

4. The risk of fraud. Fraud can occur in all pension schemes and in nearly all the aspects of the system. Pensions involve a lot of money. This might attract wrong attention. Therefore the quality of management is essential. The protection of members can be significantly improved and risks minimised by various means; for example, the legal system may provide safeguards through the imposition of duties on trustees/managers to act prudently and to seek expert professional advice on e.g. investments that they make. This is valid both for funded and unfunded schemes. In funded schemes the fraud can occur within the market (managers, brokers, investors, …). In unfunded schemes the fraud will mainly occur in the public service (civil servants, politicians, …). The Latin proverb “Fraus omnia corrumpit” applies in all cases. Fraud unravels all and hence once a contract is affected by fraud, all bets are off. Everybody who deals with pensions should be wary of fraud within the system. A clear, transparent and balanced system of check and balances within every scheme is the best prevention.

5. The political risk. No matter what kind of political system a country has, there is always a political risk of change⁶. Political stability forms an important factor in designing formal social security schemes, including pensions schemes. The political

framework in which individuals accrue pension benefits or savings may indeed change. At worst, this may mean that the entire governmental edifice collapses. But also the collapse of the public pension management or a large scale political corruption (fraud) are possible threats to pension stability. Especially in developing countries this risk may arise. In a European context, the political stability of possible new member states must be taken into account. The risk is not specifically linked to the pension issue. However, the impact of such a collapse is considerable. This is the case both in PAYG as in funded pension systems. Linked to this political risk is an overall economic risk based on the political risk. An economic stable and preferably growing environment is esteemed necessary for the financing of all pensions systems. The need for stability is not the same as inertia. Some changes are always required. It often depends on the ideological views of the politicians what changes are undertaken. The changes with the most immediate impact on pension schemes are: tax changes, changes in the solidarity mechanism, changes in the implicit social contract for PAYG schemes or changes in the solvency requirements for funded schemes. Political decisions can create uncertainty and are thus to be considered as risk elements. Aino Salomäki of the European Commission points quite correctly out that the design of the pension scheme is an important element in this. He doesn’t use the words “political risk” but refers to it as follows: The analysis of sensitivity scenarios suggests that the public pension expenditure projections are sensitive to the assumptions on life expectancy, employment and labour productivity – and hence to wages. However, the sensitivity varies considerably across countries depending on the design of pension systems as to how responsive they are to shocks. The projections are not sensitive to higher or lower interest rates as the public pensions are not funded in the vast majority of Member States.

6. The individual risk. When it comes to pensions, an individual has many risks. These individual risks can be summarised as “an incomplete social protection”. More often than not, such an incomplete social protection is the consequence of the above-mentioned risks. The adequacy of the benefits and hence the incomplete social protection can be a consequence of:

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- **Discriminatory eligibility rules.** Some employees are not eligible for pensions and do not enter within the eligibility rules. They have no pension because of exclusion. There is failure of participation.

- **Discriminatory vesting.** Some pension schemes have very stringent vesting rules leading to quasi exclusion of the scheme.

- **Financial illiteracy.** It is often questioned whether individuals should be allowed to take investment risks in pension matters. This risk is commonly avoided in Europe by obligatory collective participation of employees and trade unions. The individual risk is covered in a certain way by collective participation. Furthermore a greater worldwide focus on improving financial literacy is required.

- **Underestimating the amount of needed retirement income.** On an individual level this can be a consequence of:
  - An earlier retirement than planned by (wide spread (in European standards) obligatory pre retirement schemes due corporate restructuring, downsizing, layoffs, illness or disability.
  - A retirement at the “wrong time” because of low interest rates, low market value or inflation
  - Longevity whereby the pensioner outlives the pension money

- **Job changes.** The individual’s career path such as promotions and redundancy has a major impact on the later pension level. Most people like to uphold their income as much as possible after retirement. Individuals’ earning careers may also be disrupted due to illness or disability.

- **Health care risks.** On individual scale the cost of decent health care has major economic consequences. Social protection is a way of distributing, at the level of an entire society, costs which often exceed the means of an individual or his/her family, ensuring that paying for healthcare does not lead to impoverishment and that even those on a low income have reasonable access to care. The role of health systems in combating the risk of poverty and disease, their contribution to social cohesion and employment and the

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9 For a clear analysis on a European scale: COMMISSION OF THE EUROPEAN COMMUNITIES, Modernising social protection for the development of high-quality, accessible and sustainable health care and long-term care: support for the national strategies using the
consequences of demographic ageing have been acknowledged for some considerable time by the Union. As early as 1992, a Council Recommendation called on the Member States to “to maintain and, where necessary, develop a high-quality health-care system geared to the evolving needs of the population, and especially those arising from dependence of the elderly, to the development of pathologies and therapies and the need to step up prevention”. In 1999, health care was identified by the Council as one of the four fields of social protection where closer cooperation between the Member States was needed\textsuperscript{10}.

2. Reforms and risk transfers

Economic and sociological studies. From an economic and sociological point of view most pension schemes obviously encounter the same risks on a theoretical level. There are clear economic and social similarities linked to pension schemes irrespective of the country where the pension scheme applies. These similarities allow economists and sociologists to make comparisons between different national pension schemes (quite) irrespective of the legal nature of the scheme\textsuperscript{11}. It is often sufficient to look at the nature of the scheme in order to develop an economic or sociological study with regard to the possible risks these schemes incur. Since the risks are considered to be similar from an economic or a sociological point of view, the pension policies can be compared.

1. National reforms

Reforms. Most studies indicate that the ageing of the European population leads to some common risks. Many European analyses depart from common European denominators to define and fight these risks. The goal is to enhance the adequacy, financial sustainability and modernisation of national pension systems. When one tries to summarise all these economic and sociological studies, it becomes clear that they nearly all turn around six policies based on various

\textsuperscript{10} Ibidem.

pension risks considered to be (quasi) common risks in Europe. The policy options put forward are\textsuperscript{12}:

1. The increase of the pensionable age.
2. The decrease in pension benefits.
3. The increase of pension contributions.
4. The increase of the working populations (migrants, women, …).
5. The decrease of the state debt.
6. The creation of alternative (fiscally) favourable pension products in the second and third pillar.

These six policy options have indeed been carried through in various European Member States.

1. \textbf{The increase of the pensionable age}. This policy option is often considered to be the most effective solution. The withdrawal from the labour market is currently far below the statutory retirement age in all Member States. The measure definitely cuts two ways. It does not only reduce the number of years during which a pension will have to be paid for to the contributor, it also increases the number of years during which contributions are paid into the system\textsuperscript{13}. Early retirement reduces the labour force (and employment) and places a burden on general government finances through lower tax revenue as well as higher expenditure on transfer payments. This gives governments less fiscal latitude. No wonder demands for increasing the number of employed people have been made as long as there have been state based pension schemes\textsuperscript{14}. The measure is however unpopular and therefore politically dangerous. Furthermore the theoretical efficiency of the solution does not always correspond with practice. It seems to be a given fact that when people really want to stop working (and thus want to retire), they will try to do so no matter what the consequences are. People will try to find a way to get out of the “rat race” by examining the most advantageous way to do so. If this way is not called “pensions”, it can be found in invalidity schemes, sickness or unemployment schemes. The different sectors of social security are undoubtedly interconnected in this way. If there is no possibility to retire early, a person who wants to stop, will become ill, invalid or

\textsuperscript{13} M. BRUSSIG and M. KNUTH, Raising the statutory pension age: extending careers of unemployment of the elderly ?, ISSA, GENEVA, 2007, 17 p (paper presented at the 5\textsuperscript{th} International Research Conference on Social Security - Warsaw).
unemployed. Only when the incentives to keep on working are sufficient the person will not stop. Nowadays all kinds of reforms take place within the European Member States to create or strengthen incentives. Incentives are for example:

- better remuneration schemes for the elder (with all problems related to discrimination of younger workers);
- better working conditions (less hours, less stressing tasks, ...);
- personalised teaching in new evolutions such as computers, work processes, etcetera.

Extending working lives does not necessarily imply raising statutory retirement ages. Only the effective retirement age should be looked at. Many Member States have already taken or are planning to take measures to encourage longer working lives. These include a large range of initiatives such as:

- removing early retirement schemes;
- introducing actuarial reductions for early retirement;
- introducing contributions to individuals if they opt for retiring early;
- tightening eligibility conditions for a disability pension, extended unemployment benefit or unemployment pension;
- rewarding with higher pension accrual rates when a person continues to work beyond a certain age; and
- introducing flexible retirement arrangements, including a removal of the statutory retirement age and allowing flexible part-time working arrangements.

Within this approach it is clear that actions such as the prevention of fiscal fraud or fraud by undeclared work are major challenges within some Member States. Many European pensioners start a second “career” by performing undeclared work. It’s obvious these practices undermine pension policies in two ways. Firstly there are no contributions and secondly the pensioners receive benefits. So strict control mechanism and the prevention of fraud are to be considered the first means of pension reform in this sense. Only when this is realized possible accumulation rules between work and pensions can be examined.

2. The decrease in pension benefits. This rather drastic policy option often takes place in a rather concealed manner because of the political risk. Politicians like to be

re-elected. Lowering pension benefits is not considered a smart thing to do in that perspective. In fact, many Member States have already reduced the benefits of state based pensions for certain categories of citizens. Most of the time these measures are technically only visible for the real insiders of the system. Examples are the use of different index mechanisms for annuities, different calculations models for periods of non-activity such as for example pregnancy whereby these periods count less.

3. The increase of pension contributions. The objective of this pension policy calls on the Member States to avoid the two extremes of overburdening the active generation, notably through rising contributions, and reducing pension level below an adequate level. Nearly all Member States state that the increased expenditure on pensions cannot be financed by rising contributions. The Greek Government even “emphatically” rejects any increase in the rate of contributions, considering non-wage costs as already high. From a political point of view the refusal to increase contributions or reduce pensions seems very logical and even politically correct. However, there often is a difference between the political statement and the legal implementation. A reduction of benefits as well as an increase of the contributions often takes place in a rather concealed and indirect (often fiscal) manner. In the past some countries such as France (1987), Portugal (1994) and Germany (2001) have adjusted the calculation method. For example in Portugal, before 1994 pensions were calculated on the basis of the best 5 earnings years (of the last 10). It has been increased to the best 10 earning years (of the last 15). The rate used for the calculation has been modified from 2,2% to 2%.

Furthermore it can be questioned whether people do not have to be convinced about the fact that pensions have to cost more. Perhaps the bottom line is just that Member States indeed have to increase the contribution level. Even if this means that not all people – on an intergenerational scale – will benefit from it in the same way. Many European politicians fear such an option and considered it impossible sine qua non. The question remains whether such fear is justified.

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16 CEC, Draft joint report by the commission and the council on adequate and sustainable pensions, 3 March 2003, 54.
17 For example: German national strategy report, p. 6, 15, 19 and 20; National strategy report of the Netherlands, p. 29; Swedish national strategy report, p. 29.
18 Greek national strategy report, p. 32.
4. The increase of the working populations. Raising the employment level is clearly a priority for the Member States to sustain the national pension schemes. Achieving early entries into and later exits from the labour market becomes essential\textsuperscript{21}. Indeed, promoting an increased participation in the labour force is supposed to be effective in tackling the pension problem. According to the European Commission active ageing is one of its 10 priorities to promote full employment, productivity and labour market inclusion\textsuperscript{22}. In general, it is believed that Europe has considerable scope for improving the economic pension dependency ratio – the number of pensioners in relation to the number of people who are actually in employment – by achieving the employment goals set by earlier European Councils (the so-called Lisbon and Stockholm goals). The rationale is quite simple: the increase in the employment rate can only come from unused labour force potentials. All Member States agree on this topic. To keep adequate pension provision financially sustainable an overall European increase in the employment rates is unavoidable. However only some groups form a distinctive potential labour force reserve:

- **Women.** When the issue of raising the employment level is raised, then there is commonly made reference to raise the employment level amongst women. Several national pension strategy reports explicitly refer to women as being the major reserve (Italy, Spain and Greece still have large female employment reserves)\textsuperscript{23}. However, a lot of cultural and other problems remain. The attitude towards female labour participation in the formal sector remains a clear bottleneck in some Member states. Other ideas such as the legal recognition of household work (or other forms of informal work) are for example not widely spread within the European Union.

- **Older people.** Theoretically, the older people form an ideal employment reserve. Politically however it is very difficult to change (European) people’s attitude towards longer working. It’s definitely something that requires more than a decade to be put into effective measures. These measures require

\textsuperscript{22} The full “10 commandments” are: aid unemployed find jobs, encourage entrepreneurship, promote adaptability, invest in human capital, promote active ageing, gender equality, combat discrimination, make work pay, reduce undeclared work and promote occupational mobility.
\textsuperscript{23} For example: Spanish national strategy report, p. 8, 16, 17; Italian national strategy report, p. 15; Greek national strategy report, p. 3, 5, 12 and 24; Belgian national strategy report, p. 4; National strategy report of the Netherlands, p. 5.
political bravery\textsuperscript{24}. It has proven to be very hard to influence these attitudes towards the wide spread use of early retirement. Not surprisingly because most people want to enjoy a carefree retirement at a time when they still have sufficiently good health for it. However, the active participation of elder in the work force is clearly possible. In most Anglo-Saxon countries the participation rates of older people are far higher than in most continental European countries. This has i.a. to do with the historical European incentives for taking up early retirement in these countries. Several types of early retirement pensions exist throughout the Member States. This is of course quite the opposite of what is required to make pension systems financially sound. Often they are not solely linked to state based pension schemes but also to invalidity schemes or unemployment schemes. Furthermore, there is a clear practical danger of evasive conduct by the elder. If they cannot be pensioners, they will “use” the system to “become” for example invalids. Increasing the employment level by older people is therefore often very tricky because it requires an integrated approach within all social security schemes and also within the fiscal legislation. Anyhow, most member states stress the necessity of raising the employment level amongst the older persons. The fifth policy objective “extend working live” refers explicitly to incentives for the work participation of older workers: \textit{Ensure that, alongside labour market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pension systems facilitate the option of gradual retirement}\textsuperscript{25}. Especially, member-States with relatively high female employment such as Sweden, Denmark and Finland stress the participation of older persons\textsuperscript{26}. Denmark for example has elaborated financial incentives for older persons to remain in the labour market\textsuperscript{27}.

\textsuperscript{24} “This past trend is already being reversed. Policies in the Members States have been geared towards greater participation and higher employment rates of older workers, and recent years already show some progress”. CEC, Draft joint report by the commission and the council on adequate and sustainable pensions, 3 March 2003, 50.

\textsuperscript{25} CEC, Draft joint report by the commission and the council on adequate and sustainable pensions, 3 March 2003, 50.

\textsuperscript{26} E.g. Swedish national strategy report, p. 14.

\textsuperscript{27} Danish national strategy report, p. 1, 6, 7: A special tax-exempt premium for people who postpone entering voluntary early retirement was introduced together with the means testing
- **Disabled and socially excluded.** In view of their fairly tight labour market situations, Denmark and the Netherlands also point to the potential labour reserves among people on disability benefit and the socially excluded\(^{28}\). These labour reserves are rather small compared to the reserves represented by the female and the older workforce. Furthermore, the financial effectiveness can be doubted. In general these people receive benefits of social security or social assistance and most Member States have complex regulations on the accumulation of these benefits with remuneration.

- **Migrants\(^{29}\).** Almost all Member States have experienced a substantial net immigration from third countries in the last decade\(^{30}\). An increase in immigration is considered to be positive because it creates new contributors to the pension scheme. A rise in the number of migrants is a variant of a rise in employment level. More migrants mean more workers who can pay the pension bill. However, apart from not being considered to be a decisive difference according to economic models, it is often politically difficult to implement in some Member States. The economic question seems not to be how many migrants come into the Union but rather what the added economic value of the migrants is. Idea is that they can help to support the system instead of being a burden to the system.

5. **The decrease of the state debt.** Public debts weigh heavily on pension policies. At least on the state based pension schemes which are unfunded\(^{31}\). The reduction of public debt and the accumulation of public pension reserve funds are often mentioned at the same time. They are like twins and often closely linked. Indeed

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for all forms of pension savings in the early-retirement benefit, where previously only certain types of current pension payments were set off; easier means testing for pension savings when the shift to the early-retirement benefit is postponed; and greater flexibility as regards work in the retirement period.

\(^{28}\) CEC, *Draft joint report by the commission and the council on adequate and sustainable pensions*, 3 March 2003, 46.


\(^{30}\) CEC, *Draft joint report by the commission and the council on adequate and sustainable pensions*, 3 March 2003, 43.

\(^{31}\) Policy objective 6 states: “Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.” CEC, *Draft joint report by the commission and the council on adequate and sustainable pensions*, 3 March 2003, p. 61.
many member states aim at using budgetary surpluses for reducing public debt or building up reserve public pension funds and, accordingly, at using the decrease in future interest payments for financing the budgetary costs of ageing. The ratio legis is clear: by establishing reserve funds large increases in contribution rates or taxes can probably be avoided. Financially, reserve funds or the reduction of public debts are the instruments by excellence for the consolidation of the state based pensions. Reserve funds can be found more and more in European Member States. Significant reserves for statutory pension schemes already exist in Luxembourg, Sweden, Denmark and Finland where requirements for partial funding have already been in place for a long time. New reserve funds have recently been established in Belgium, the Netherlands, Spain, Greece, Portugal, France and Ireland. Accordingly, the amount of assets accumulated so far in the recently established funds is low. The general intention is to increase such assets, to varying degrees through a commitment to make regular transfers, before ageing populations require pension expenditures to increase.

6. The creation of alternative (fiscally) favourable pension products in the second and third pillar. This policy option remedy is the most vague remedy. It mainly refers to an increased role of the occupational and individual pension schemes with emphasis on a shift from an unfunded PAYG finance technique to a funded finance technique. Funded pensions schemes are thereby sometimes presented as the life guards of the drowning unfunded schemes. This drowning is related to the demographic changes. The debate is however far more complicated because funded pension systems are not always economically better than unfunded systems. A lot depends on the actual economic situation in which the differences between the funded and unfunded systems are measured.

2. European pension policy

Europe is there. At least economically. Apart from the national pension policies there is an ever increasing European pension policy. Although it is legally obvious that pensions are a national competence and not a European competence, some remedies are embedded in the general economic policy of the European Union. Migration policy is a classical example. There is indeed an increasing European policy on common migration objectives. The same applies to the reduction of public debt. The famous stability and growth pact and the Maastricht criteria contain criteria for the containment of public expenditure.
**EU pension objectives.** In order to tackle the so-called “pension problems” within the EU multiple objectives and policies have been formulated throughout the years. The last major evolution took place in 2001 whereby the Member States agreed on 11 common EU objectives designed to secure the future of their pension systems and also agreed to cooperate in accordance with the open method of coordination. These eleven objectives refer to three chapters. Under the first chapter entitled “Adequacy”, we can find three objectives namely: (1) prevent social exclusion in old age; (2) allow people to maintain their living standard and (3) promote solidarity between and within generations. Financial sustainability of pension systems is the second chapter whereby the objectives are to (4) raise employment levels, (5) extend working lives, (6) ensure sustainable pensions in a context of sound public finances, (7) adjust benefits and contributions so as to share the financial consequences of ageing in a balanced way between the generations and (8) ensure that private pension provision is adequate and financially sound. Furthermore the pension schemes should respond to changing needs (third chapter). Pensions should therefore (9) adapt to more flexible employment and career patterns; (10) meet the aspirations for greater equality of women and men and (11) make pension systems more transparent and demonstrate their ability to meet the challenges.

Further? The question is thus not if we want a European interference in the pension debate or not. The interference is clearly and unmistakably already there. The question is whether we want it to go further than the current economic measures that have a (mostly indirect) impact on pension policies. It is clear that the European dimension of the pension policy debate is ever increasing. Especially the last five years there is a clear active European policy to suggest solutions for the so-called pension crisis. In March 2002 for example at the Barcelona summit, the council decided that “A progressive increase of about five years in the effective average age at which people stop working in the European Union should be sought by 2010”.

This is just a mere example but it is very indicative for the visions currently developed at the European level.

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33 Barcelona European Council, 15th and 16th March 2002. The citation fits into the chapter of the reinforced employment strategy. Under point 32, which highlights the employment
Actions and realisations. However, when we look at the reality only in a limited number of areas real actions have been undertaken, these are mostly linked to the Internal Market and the Single Currency. These areas are – non surprisingly – related to some of the corner stones of the European Union and are legally embedded in a community framework

The areas in which actions and realisations have taken place, are:

- **The Free movement of people.** With relation to the portability of pension rights the free movement of people (art. 42 TEC) has proven to be very important. Particularly known is regulation 1408/71 on the co-ordination of social security schemes, that mainly covers statutory schemes. However, occupational schemes can be included in the scope. The objectives are: (a) that a single stated cover applies to employees who live or work in another Member State; (b) that when pension rights begin, all periods in which a person has been insured in accordance with various national systems count towards the calculation of the pension; (c) that the pension can be paid in another Member State after retirement. Another known legal instrument on the implementation of pension portability is directive 98/49/EC of 29 June 1998 on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community. The directive ensures equal treatment of migrant workers and national job changers regarding their occupational pension rights. It ensures that vesting (preservation) applies throughout the Union when they move to another Member State. A new proposal of directive on portability was recently altered in such a way that it is no longer upheld as a real portability directive.

- **Freedom of establishment and freedom to provide services.** The articles 43 TEC and 49 TEC have played an important role in creating a single market for occupational pension providers. Several directives have established a single

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35 This is already the case for the French AGIRC and ARRCO schemes and the Swiss mandatory pension funds.

36 The full title of the original directive was: Proposal for a Directive of the European Parliament and the Council on the improvement of portability of supplementary pension rights. Originally the Commission had made an ambitious proposal which would have enabled workers to enjoy true portability of their pensions. Many people have expressed disappointment at the removal of provisions to assist the transfer of pensions, but welcomed the report's clear commitment to setting minimum standards for the access to pension rights.
market for life insurances. Three former Council directives related to insurance matters have been amended by directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance. The so-called IORP directive is also based i.e. on the articles 43 and 49 TEC. The IORP directive is directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision. This directive aims at establishing minimum prudential standards, defining the role and responsibilities of supervisory authorities, proposing a qualitative approach to investment rules, according to which investment portfolio management should comply with principles (diversification, security, quality) and not uniform quantitative requirements. The directive is also designed to allow cross-border management of occupational pension schemes - an institution in one Members State would be able to manage company pension schemes in other Member States. In the same manner there is a Commission strategy on the elimination of tax obstacles to the cross-border provision of occupational pensions. The commission proposes a comprehensive strategy to address the tax obstacles that currently can act as a major disincentive to individuals wishing to contribute to pension schemes outside their home Member State and pension institutions that wish to provide pensions across borders.

- **Free movement of capital.** Article 56 TEC prohibits restrictions on the free movement of capital. The IORP directive facilitates the free movement of capital by abolishing uniform quantitative investment requirements.

- **The promotion of high standard regarding workers’ rights.** Two directives have been based on article 137 TEC. These are directives 80/987/EEC of 20 October 1980 (on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer) and fair treatment of dormant rights. For more information on the work and progress of the directive: [http://ec.europa.eu/employment_social/emplweb/news/](http://ec.europa.eu/employment_social/emplweb/news/).


38 A fully functioning single market for occupational pensions is essential to ensure that citizens are able to exercise their rights to free movement enshrined in the Treaty establishing the European Communities and to enhance labour mobility. The Commission therefore proposes a comprehensive strategy to tackle tax obstacles liable to be a disincentive to individuals wishing to contribute to pension schemes outside their home Member State and pension institutions that wish to provide pensions across borders. See also: [http://ec.europa.eu/taxation_customs/resources/documents/occ_pen_article3.pdf](http://ec.europa.eu/taxation_customs/resources/documents/occ_pen_article3.pdf); [http://europa.eu/scadplus/leg/en/lvb/l31056.htm](http://europa.eu/scadplus/leg/en/lvb/l31056.htm).
and 2001/23/EC of 12 March 2001 (on the approximation of the laws of the Member States relating to the safeguarding of employees’ rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses). The directives require Member States to take the necessary measures to protect workers’ supplementary pension rights.

- The promotion of equal treatment of men and women. Based on article 141 TEC plenty of pension jurisprudence has been developed. These court cases have partially already been transformed into council directives. Directive 79/7/EEC of 19 December 1978 on the progressive implementation of the principle of equal treatment for men and women in matters of social security allows discriminations regarding the retirement age and survivors’ pensions, but calls for them to be phased out. Article 141 requires equal treatment with regard to occupational schemes which are regarded as pay. This is reflected in Directive 86/378/EEC of 24 July 1986 on the implementation of the principle of equal treatment for men and women in occupational social security schemes amended by Council Directive 96/97/EC of 20 December 1996.

Not impressive. This list of European realizations is far from impressive. At a European level there is a lot of talk about pensions but little real action. Guidelines and indicators are formulated at regular intervals but without any real impact on the national pension policies.

Reality. Europe is confronted with the European pension reality. 27 different member states are ideologically and historically quite different when it comes to technical pension issues.

Social Justice. Furthermore, the little that has been done in Europe is heavily questioned. There is an increasing criticism on the European Law field due to the lack of so-called social justice. There is even a group of academics that have formed a Study Group on Social Justice in European Private Law. The Group wishes for a European contract law that respects cultural diversity ant at the same time introduces
regulatory techniques that enjoy legitimacy in a multi level pluralistic polity. The social quality of Europe can indeed be questioned.

3. Economic similarities without legal background

No reality. The ideological and historical differences between the member states are obvious for lawyers and technicians. However most analyses at the European level are made by economists and sociologists without technical (legal) background. The theoretical framework they use, refers to the risks and policies mentioned above:

Two worlds. The economic and sociological analyses of the European pension issue differs strongly from the legal analysis. On a macro-economic level the risks and policy reforms show undoubtedly similarities. Certainly in the eastern European countries these resemblances are clear. This is not surprising since the risks are

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39 O. LANDO, Liberal, social and ethical Justice in European Contract law, COMMON MARKET LAW REVIEW, 43, 2006, 819-820. The group has defined quite a lot of parameters examining this kind of justice.
considered to be similar from an economic or a sociological point of view. From a legal and technical point of view: the similarities are quasi inexistent (see below, chapter 3). Hence it is also normal that the European policy level has a little impact on the actual legal situation in a Member States. This leads to two different worlds. There is on the one hand a socio-economic world dealing with similar risks and similar policy options. On the other hand there is a legal world where there are very broad technical differences between the Member States making comparisons very difficult and reducing all European pension decisions.

**A European Social Model?** The existence of these two worlds becomes more and more visible in the academic literature. Many socio-economists claim a so called “European Social Model” and consider the “Open Method of Coordination (OMC)” a valid pension policy. Lawyers on the other hand point out that there is absolutely no such thing as a European Social Model. Furthermore most lawyers consider OMC as a sociological interpretation of something that has always existed: comparative law.

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41 The European social model has eight common European dimensions: values, common identity, partnership, common challenges, common institutions, common policy processes, commitment for welfare state/society and some other common European dimensions. The notion is widely used amongst academics but has little to none practical impact. For a detailed study of the notion: Ministry of social affairs and Health of Finland, *The Europeanisation of social protection: the political response of eleven Member States*, EC, HELSINKI, 2006, 280 p. This book was written during the Finish presidency of the European Union.

42 The OMC gives a framework to a mutual learning process including a periodical monitoring of the progress made by each Member State on the basis of commonly agreed and defined indicators. Applied to pension reforms, the OMC seeks to co-ordinate the action of national policy makers whereby the learning from abroad is seen as an instrument to identify “best practice”. The joint report of the Social Protection Committee and the Economic Policy Committee on objectives and working methods in the area of pensions is clear on the contribution of the OMC: to integrate the economic and social dimensions and to provide:

- An integrated reporting framework on all issues relating to future pension provision;
- A framework for different actors at the EU level to develop a common understanding of national strategies in this regard; and
- Detailed information and analysis regarding national pension strategies which will feed into the formulation of policy recommendations within the Broad Economic Policy Guidelines and in the preparation of other processes ([Joint report of the Social Protection Committee and the Economic Policy Committee on objectives and working methods in the area of pensions: applying the open method of co-ordination, 23 November 2001, 14098/01, p. 4.]).

For this method to be effective, Member States should submit national pension strategy reports which describe their comprehensive policy strategies for securing the sustainability of pension provisions and, where necessary, for modernising pension systems. They should mainly focus on pension systems and contain information on reforms in all policy domains relevant to pension systems, which have been carried out recently or which are envisaged. If possible, they should also contain relevant data which will help to assess progress towards the broad common objectives, including the long-term sustainability of pension systems. Basically, the open method of co-ordination (OMC) is a mutual learning process. As such the OMC is only giving a framework to something that has already existed for a very long time. A process of learning from and with other countries is very familiar to lawyers. They are used to work with comparative cross-country legal analyses.
Europe is not there. At least legally. The practical and technical reforms dealing with the pension risks differ widely amongst the 27 member states of the European Union. These wide national differences are mainly the result of the historical, demographic, economic, political and ideological diversity within the European Union. If it comes to pension policy, each Member State differs clearly in one way or another from the other Member States.

3. Risks and reforms: legal variety

Pension law. Politicians are responsible for pension law and thus for the pension schemes. Although they might not write the law themselves, they still assume the full responsibility towards the public for every change in pension law. Confronted with the various risks and the different pension policy options European Member States have increasingly reformed their pension schemes. These changes can socio-economically be quite similar (above) but in the outcome of technical detail they are definitely not similar.

No modelling. Pensions, as a part of social security, are considered a national competence under European Union law. Historically the different national pension systems have evolved separately and have typical national characteristics. Although there has been some exchange of elements in a comparative law perspective, these exchanges of bits and pieces of pensions systems and pension policies have certainly not lead to a common unified pension structure or something like a “European pension model”. It can even be doubted that the classical distinction between the so-called Bismarckian, Beveridge or Scandinavian type of pensions has any sense. Legally the national systems are all very different and it is quasi impossible to put the legal differences in conclusive socio-economic models.

Non-existing three pillar model. Legally, the so-called three pillar model differs strongly between states. The three pillars in the UK do not for example reflect what the Swiss consider the three pillars to be. Legally, there even is not a three pillar model. The differences are too obvious between countries. The strength of the model is indeed of a sociological (or sometimes economic) nature: (nearly) everybody – irrespective of nationality - can recognise his proper national pension system in the
model\textsuperscript{43}. Within Europe there has been a large discussion on the terminology of the three pillars. Mainly two approaches were given: the worldbank approach\textsuperscript{44} (with a quasi mandatory second pillar) and the ISSA approach (with a stronger first pillar basis). The 12 new Member States did not reach an agreement with the 15 older Member States. Ever since there is no talk anymore about the modelling in pillars.

**No legal modelling.** The modelling of pension systems always risks to put too much emphasis on a certain element of a pension system without taking into account other – equally relevant – elements. We strongly doubt the practical relevance of all kinds of modelling of pension systems into general types. So, when one looks around in Europe and tries to define - in a legal manner - the different pension systems, one can only notice that there is a huge variety of elements constituting the pension systems. It is this variety of systems that actually complicates the European policy debate.

**13 technical elements.** The true variety in Europe really becomes clear when analysing the concrete national reforms looking at 13 elements:

1. The acquisition condition of a pension
2. The calculation method
3. The affiliation rules
4. The level of organisation
5. The various actors interfering in the pension scheme
6. The booking of the pension scheme
7. The coverage rate of the schemes
8. The fiscal treatment
9. The control mechanisms of the pension schemes
10. The participation levels
11. The cost bearing of the scheme
12. The methods of financing

\textsuperscript{43} For more details, see: S. St John and L. Willmore, “Two legs are better than three: New Zealand as a model for old age pensions”, International Research Conference on Social Security, Helsinki, Finland, 25-27 September 2000, this paper can be downloaded at \url{http://www.issa.int/pdf/helsinki2000/topic3/2willmore.PDF.} The level of “recognasibility” of the model is due to the World Bank. The famous report titled “Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth (Oxford University Press: Oxford, 1994), popularised the concept of a pension system supported by three pillars. Ever since there have been many interpretations (WORLD BANK, \textit{Averting the old age crisis: policies to protect the old and promote growth}, Oxford, Oxford University Press, 1994, 402 p.).
13. The role of the government in the definitions of the previous elements.

1. The acquisition condition of a pension

To acquire a pension various systems exist throughout the European Union. Three sets of conditions are clearly present in most systems: (1) a certain citizenship, (2) a certain number of worked years or (2) a certain amount of paid contributions into the pension scheme.

Most analyses start from one of these three parameters in describing the acquisition condition of pension systems\(^4\). However when we look at the pension legislation in various Member States it becomes obvious that the three systems have been used simultaneously in various stages of different schemes. This leads to the effect that most Member States know these three forms of acquisition but that it is mostly a mixed system. This is even true if we look at one specific so-called pillar. It is legally wrong to state that most occupational pension schemes in Europe base their acquisition condition on for example paid contributions. An increasing number of occupational pension schemes of Eastern European countries require for example European citizenship. Or in the Dutch model: the working years are a more important acquisition condition than the paid contributions. With some of the book reserves systems in Germany the working years condition is clearly the most important condition.

The different forms of acquiring a pension are present in all Member States irrespective of the type of pension scheme. Member States know a mixture and so Europe is confronted with an enormous mix of systems. The diversity rules\(^5\).

2. The calculation method


There are various calculation methods when it comes to pensions. Well known are: defined contribution, defined benefit and cash balance. Several variants exist of these types. Elements in the formulas can be:

- **Earnings related**
  - Average career earnings
  - Last five years earnings
  - Last year earnings
  - Average earnings
  - Of the age cohort of the population to which the employee belongs
  - Of the age cohort of the employee within a branch of industry
  - Earnings above or below certain ceilings linked to social security schemes
  - …

- **Working years related**
  - Average calculations
  - 30, 35, 40, 45 or 50 years calculation\(^{17}\) (up to 60 years for some branches of industry in for example Belgium !)
  - Calculations having a direct link to the number of working years in social security schemes
  - …

- **the return of investment**
  - guaranteed (ceiled or not ceiled)
  - no guarantee but return based on other elements such as age, seniority, …
  - …

- **Means tested formulas**
  - Minima amounts given as a pension irrespective of the outcome of the formula
  - Maxima amounts given as a pension irrespective of the outcome of the formula

It is quite commonly believed that some of these techniques are closely linked to some type of pension scheme. For example means tested formulas are often linked to state based pension schemes (the so called first pillar). This is definitely not true. Various French, Spanish and Belgian examples exist whereby there is a form of
means testing in sector wide occupational pension schemes (some in (open)
capitalisation and some in repartition). The variety in European Member States is
truly enormous.

3. The affiliation rules

Most state based pension schemes know an obligatory membership in one way or
another. This obligatory membership is organised in various ways. In some Member
States citizenship equals for example membership.

In other Member States there is a more categorical approach to membership. There
the membership is linked to a certain category of workers such as civil servants, self-
employed, blue collar workers, white collar workers or others. In these cases
membership is linked to the relevant national social category of employment,
irrespective of citizenship.

The legal differences between the two approaches are significant and lead to major
differentiations in the approach towards questions such as a minimum pension or a
minimum level of subsistence for the elder. The legal differences also explain why
there are no Member States whereby everybody – irrespective of citizenship and
employment – receives a pension from the state. There are always remain parts of
the population, which are not covered.

For most occupational pension schemes throughout the EU, membership (or rather
affiliation) is organised through the employer or through representative organs of
employers and employees (on a sector-wide scale usually). For the affiliated
employee, self-employed or civil servant the affiliation is a consequence of the labour
agreement with the employer. Most of the time the employee cannot refuse this
affiliation. For him the affiliation is obligatory. For the employer the organisation of the
occupational plan can either be voluntary whereby he chooses to organise (or
participate in the organisation of) an occupational pension scheme or has, at least,
the right to refuse the participation in an occupational pension scheme. When an
employer cannot refuse to organise or cannot refuse to participate in the scheme,

47 For an overview of pension ages: J. TURNER, Social Security pensionable ages in OECD
affiliation is mostly obligatory for all or a certain category of employees (mixed affiliation systems).

Pension provisions organised on the individual scale are mostly voluntary. Although a lot depends on the definition of the scope of the notion of “individual pension provisions”. The fiscally advantageous treatment of mortgages is for example for some Member States part of these individual pension schemes whereby there is a certain limit to fiscal deductibility of life insurance premiums including (a certain amount of) mortgage payments. Although, such fiscal deductibility is mostly obligatory for all citizens (sometimes referred to as the “fiscal personal credit”). Such fiscal treatments may not be considered as “pensions” in the strict sense, they surely have a relevance in the pension policy.

4. The level of organisation

Pensions are organised on all different kinds of levels. The distinction between state based pensions, occupational pensions or individual pensions goes far further than the so-called three levels of the state, the company and the individual. Up to a certain degree it is obvious that all stakeholders are involved in the organisation of all pension forms. At least, when one reads the word “organisation” in a very broad meaning. Such meaning is nowadays quite common when we look at the “corporate (social) governance debate” or at debates on “socially responsible investment”. All stakeholders are invited to participate in the debate. However, this is not exactly what is meant by level of organisation.

The level of organisation is mostly synonym for the right to initiate the pension. This right can lay with

- the State (state based pension schemes),
- the social partners in certain branch of industry (sectoral pensions),
- the company (occupational pensions within the company) or
- the individual (personal pension provisions).

However, this right can be mixed as well. For example in pension systems whereby individuals can opt out of certain pension schemes initiated by the state, the branch of industry or the company. The same applies for an opting out by a company out of the state based scheme or out of the sector-wide scheme.
Legally, all kinds of fine distinctions between national systems have been done whereby there is mostly a clear fine tuning between the different levels. For an outsider it is therefore often easy to simplify the different levels, but it is usually also quite wrong (in a legal sense).

5. The various actors interfering in the pension scheme

The state, insurance companies, pension funds and banks are the best known actors in pension schemes. The applicable regulations and laws differ strongly between them. This has a clear incidence on the schemes themselves.

In the so-called three pillar model there is a clear distinction between these actors. Simplified: the state is first pillar; insurance companies and pension funds are second pillar and banks are third pillar. However this is not true. A European legal analysis makes it clear – who could have guessed – that the state (by means of a national pension authority) is also an insurance company that can work in the so called second pillar in Member States such as Belgium, France, Greece and Bulgaria. The socio-economic distinction between pillars is definitely not valid when it comes to the various actors.

Furthermore there are a lot of insurance companies who also run pension funds or banks and vice versa. The distinction between these various actors also differs strongly between Member States. A Luxembourg bank is different from an Italian or a Greek bank. Even if there are some common European directives and even regulations the differences between Members States remain.

6. The booking of the pension scheme

Another element in the pension system is how pensions are booked. Some Member States allow extensive internal booking by companies of their occupational pension provisions. These bookings have a direct impact on the economic viability of the companies and hence the country.

Most state based pensions schemes (leaving aside the opting-out models) are based on a PAYG or unfunded method of capitalisation. However with the current debate on
solutions to the demographic changes quite a few Member States have adopted a policy to create buffers or so called reserve funds.

These reserve funds or buffers are usually booked on the public expenditure note on the “credit” side. State based PAYG pension systems are considered debits for the state booking and are part of public expenditure. So the reserve funds allow a balancing of the public expenditure. Most, if not all, personal pension schemes are booked externally with a bank, an insurer or a kind of fund. This also means that the individual cannot influence the height of the build up reserves or provisions.

7. The coverage rate of the schemes

Pension schemes can be nation wide, sector wide, company related or individual. Schemes that are nation wide are mostly state based schemes. Sector wide or company related schemes are mostly occupational schemes. The individual schemes are mostly not linked to a company.

However there are many exceptions. Some French occupational pension scheme are for example organised on a nation wide basis. Some German and Belgian individual schemes can only be given within certain companies. Systems of opting-out, opting-in or even opting-up are so wide spread in some Member States that the exception has become the rule. The Italian open pension funds allow for example anyone to enter voluntary and there is no obligation to stay within the scheme. Some would call this a second pillar pension although it has all features of a so-called third pillar.

8. The fiscal treatment

Fiscal measures have always been a tool in pension policy. Most pensions schemes (state based, occupational or individual) often know a specific fiscal regime on it’s own. Most of the time this is combined with various exceptions for the low pensions or categories of pensioners who are esteemed socially vulnerable. The tax level of state based pensions is usually related to the tax level of minimum subsistence incomes for the elder or to the tax level of housing (if any).

The taxing of occupational pensions related to companies or industry wide schemes is often more complicated, since there are three possible moments of taxation: when
the contribution is paid, when there is a return on investment or when the pension benefit is actually paid. Theoretically it is possible that there is a tax exemption at all three moments or (less theoretically) that there is taxation at all three moments.

The system can vary from a so-called EEE system (three times Exemption) to a so-called TTT system (three times Taxation). In between lay various models whereby the European Commission is increasingly inclined to propose the EET system as standard for all Member States. This means that there is no tax on the contributions paid into the pension scheme and that there is no taxation on the return of investments during the build-up of the scheme, while the pension benefits themselves are taxed. For the individual pension schemes there is often a tax credit whereby the State actually encourages the individual to save some money for his old age.

9. The control mechanisms of the pension schemes

Various control mechanisms exist within Member States to check whether the pension systems are run properly. A mixture of authorities check the legal, prudential, social and financial constraints of the different pension systems run within a Member State. These various authorities work according to quite different standards throughout the European Union.

The debate goes far further than the question whether occupational pensions should fall under a supervision lead by the prudent man’s principle or under a strict state supervision. The debate for example also includes the question whether those who need to pay the contributions for the state based pensions pay them correctly. All different control mechanisms are closely linked with the different roles the administrations play in the pension systems. After all, not all administrations in the European Member States retain the same powers. In some Member States high civil servants retain quite a lot of power to shape the social security and hence pension systems. The role and the power of the administration are therefore also reflected in the role of the government itself.

48 See for example all documents listed under the heading “elimination of tax obstacles of the cross-border provision of occupational pensions” on the website of the European Commission: COM (2001) 214. These documents make a listing whereby it cannot be denied that the Commission is inclined to move towards a uniform taxing system so as to improve portability.
10. The participation levels

The role of the social partners in European pension systems is relatively important compared to other countries outside of the Union. It is not uncommon in European Member States that the social partners participate actively in the policy of the state based pension schemes. They can for example be found in many governing administrative bodies with advisory or even regulating power.

The classical and historically embedded role and power of the social partners is legally reflected in the different forms of pension schemes. In schemes whereby the social partners have for example regulatory power by means of collective labour agreements their role in the field of social policy of pension schemes is often dominant. Usually their regulatory power is accompanied by managing power. In company related occupational pension schemes whereby the right to initiate the scheme lies entirely with the company, their role is much less important and their role is often restricted to an advisory role\(^{49}\). In other company related occupational schemes the role of the social partners includes the management of e.g. the pension fund.

11. The cost bearing of the scheme

A currently hot issue in the pension debate concerns the question who should carry the risks related to pensions. These risks are numerous and occur at several levels. Longevity is for example a problem that occurs in the state based pension schemes as a macro-economic fact but can also be a problem in occupational pensions.

If for example there are lump sum payments the question raises whether the lump sum will be sufficient to cover a decent replacement ratio or if the pensions are paid in annuities whether these annuities need to be indexed or not. Different Member States have adopted various solutions to these problems by for example installing an obligatory index that is linked to the general welfare level.

Another risk that can occur in occupational pensions is the insolvency of the employer or the insolvency of the pension fund or insurers. Some Member States have adopted legislation obliging re-insurance while other Member States have created individual accounts whereby the state covers the risk. Another element in the debate on risks relates to the shift from defined benefit pensions (DB) to defined contribution (DC) pensions. There is an increasing number of DC plans in the Union. On the one hand there are an increasing number of European employers who change their existing DB scheme into a DC scheme. On the other hand (and statistically more important) most newly set up plans are of the DC kind. The shift from DB to DC has to do with the bearing of risks. Generally, in DB schemes the employers carry the risks related to the return on investments while in DC schemes the employer carries this risk. Theoretically the risks related to pensions can be divided between the individual, the social partners, the employer(s) or the state. When the state takes over all the risks, then it is society at large that pays for possible deficits.

12. Methods of financing

Repartition or PAYG is no monopoly of state based pension schemes. Legally, there are occupational pensions based on PAYG in various Member States\(^\text{50}\).

Correspondingly, funding or capitalisation is no monopoly of occupational pensions or individual pension schemes. It’s even common that most state based pensions schemes have a – marginal – part of funding within the systems because of the time laps between the moment the contributions come into the system and the pensions are being paid. Legally, this form of funding is embedded in so called “time constricted (closed) capitalisation systems”. This means that there is a permanent flow in the basic assets but that these assets are stable (therefore closed). Most occupational pension schemes know a legal form of capitalisation that is considered to be “open”. This means that new money from new members can come in continually. Some Member States require closed capitalisation from the moment an occupational pension scheme is shut down and the only members that remain are the so-called sleepers with postponed rights.

\(^{50}\) Y. STEVENS en B. VAN BUGGENHOUT (ed.), Sectorpensioenen, Die Keure, Brugge, 2000, 278 p.
13. The role of the government

Governments intervene – by their administrations – in a variety of ways in pension systems. The organisation, the controlling, the regulating or the managing of pension systems can be in the hands of governments. In most pension schemes all these different roles of the government can even be found simultaneously in different degrees. The role of the government for most state based pension schemes includes for example management and organisation (apart from opting-out models) while the management of individual pension schemes is usually left to private actors such as banks, insurers or funds.

It is obvious that the regulating task of the government can be found in all pension schemes but the government surely has no monopoly in this field. In most Member States the important regulating role of the social partners is recognised. Sector wide funds are for example usually initiated by social partners and hence also regulated by means of collective labour agreements.

4. An enormous legal patchwork

Patchwork. The result of this technical analysis shows that the European pension landscape is a huge colourful patchwork. It is clear that the different member states have reacted very differently to the same risks with very different solutions. Due to the quilt and the multiplicity of solutions it has become quasi impossible to give a unique European answer to the various pension problems. The national differences are often too big. Europe can definitely not be considered as a monolith when it comes to interpreting pension risks and pension reforms51.

51 The analysis shows that each country is clearly different. The warning the WHO made in April 2007 to developing countries not to copycat pension systems available in the west is therefore important. WHO specialist Somnath Chatterji stated that based on current ageing issues in the developing world, other regions should not imitate European systems as they will not be sustainable (IPE news site, 19 april 2007, www.IPE.COM). The warning makes it clear that some people really believe pension systems can be copied. This is obviously not the case.
A legal patchwork quilt. When one looks at all these different elements then it becomes quite clear that Europe is actually a legal patchwork quilt of pension elements. This does not necessarily have to be a negative (or for that matter positive) element. It is a given fact. Devising cross European legal typologies or legal models of pension systems is therefore very difficult, if not impossible. Apart from the fact that it is difficult, it is also certain that it has little to no legal consequences. Legally, the various elements and techniques make every Member State unique.

No legal three pillar model. Consequently it is also clear that there is no so-called three pillar model. Legally, there is only a wide variety of pension elements and structures. However this so-called key structure of pensions is often used as reference model. The strength of the model is indeed of a sociological (or sometimes economic) nature: (nearly) everybody – irrespective of nationality - can recognise his proper national pension system in the model52. The broadness of the used definitions and terms explains the high visibility for all. There is however also a certain political dimension to the three pillar model. The model suggest that there are three pillars with somehow equal weight. The figures however indicate clearly that the so-called first pillar or state based pension schemes dominate by far – both financially and politically – the scene. Only in a few countries where occupational pensions have a quasi-obligatory nature through collective labour agreements, whereby the balance is (slightly) different. In general the so-called third pillar is a “light weight” compared to

the other two. However on the neo-liberal political scene the model is presented as if the three pillars can be equally important in the finding of solutions towards the "so-called pension time bomb".

**No “pension” definition.** The consequences of the legal patchwork quilt lead to an evident absence of a uniform “pension” notion within the EU. The debate on what should be considered a pension reaches very far. In most Member States there is for example a classical distinction between the invalidity pensions and rest or survival pensions. Often, the notion “pension” is not even used as a legal synonym within the Member State. Some Member States have detailed rules on cumulation between invalidity pensions and rest or survival pensions. Another classical question on the scope of the pension notion deals with the question whether lump sum payments can be considered as pensions or not. Classically pensions are considered to be annuities or periodical allowances. Most public pension schemes provide annuities corresponding to the social value of maintaining a permanent and stable level of retirement income. In some occupational pension schemes lump sum payments are possible. These forms of pensions fulfil a socially different role. They enable savings and do not always reflect the social value of maintaining a permanent and stable level of retirement income. Legally lump sum payments are mostly considered to be pensions but can be fiscally differently treated than annuities. This fiscal difference reflects the ideological approach towards pensions by a national legislator.

**Conclusion : no common European legal pension basis**

All the differences mentioned in the patchwork quilt are culturally and historically embedded in national traditions. Sheer simplification by means of modelling pension systems is dangerous in a sense that if political action is taken on a European level not all national consequences can be overseen. Some lessons should therefore be learned.

Firstly, a certain form of modesty – or even reticence – in explaining and comparing pension systems is required. An often-heard remark is that economic data are difficult to compare. This is also true for a legal comparison of pension systems. The same social goal can often be reached by different means and it is therefore difficult to draw conclusions that are internationally valid. Certain elements that seem to be
regular or standard within a Member State cannot be found in other Member States at first sight. However, they might be found in different elements or techniques.

A second lesson is that the differences in all the pension systems are often embedded in more general legal structures of a Member State. Pension systems do not stand in a legal vacuum. Especially occupational pensions or pension provisions based on the initiative of the individual are legally embedded in civil/common law of the Member States.

Thirdly, the elements related to the financing of pension provisions are often related to other finance elements of social security and sound public finances in general. These should be taken into account when a common European pension policy is being developed.

Economic and sociological studies use common and internationally valid parameters to analyse pensions. This leads to certain economic policy guidelines. However the legal differences often remain clearly visible between Member States. More should be invested in research programs that combine different research areas.

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