Towards a New Design for Workplace Pensions

Leveraging Defined Benefit Pension Design to Strengthen Workplace Pension Solutions for the Future in Europe

Foreword

PensionsEurope promotes good pensions for the people in Europe. The present paper provides a manual for a new design for Defined Benefit (DB) workplace pensions. It gives an insight into what a good workplace pension should look like in order to ensure adequate, sustainable, reliable and efficient pensions for European citizens. It is a manual for Member States and stakeholders reflecting on introducing or reforming already existing workplace pension systems. Based on the experience of mature pension countries and their reforms in the current economic and financial circumstances, the paper is a guideline towards better pensions for all.

This paper was prepared by the DB Standing Committee of PensionsEurope. The DB Standing Committee recognizes the valuable contributions that were made during an industry Round Table meeting in Brussels that was organized earlier in 2017, for which we would like to thank those that participated. Nothing in this document can be construed to nor directly relate to any comments and suggestions that were made at this Round Table meeting.

PensionsEurope aims to be the thought leader in Europe and beyond on workplace pensions and we present this paper as a contribution to the evolution of DB pension plans. Through our Member Associations and our Corporate and Supporter members we have access to resources and expertise that we will use to further the debate on DB pension plans and that will help to ensure better outcomes for members.

PensionsEurope chair
Janwillem Bouma
8 June 2017

Executive Summary

Across Europe, the majority of pension assets are still under Defined Benefit (DB) management while at the same time there is a growing trend towards the establishment of Defined Contribution (DC) pension plans for ongoing workplace pension provision. Against this changing backdrop, PensionsEurope has engaged in a forward looking consideration of developments in order to contribute to the evolution of pensions. The aim of this paper is to provide a framework for modern pension solutions in order to achieve good pension outcomes for participants and beneficiaries linking the best of the DB and DC world. This paper recognizes that the majority of new pension design ideas use elements from the development of DC plans, whilst there is a lot that can be learned from current DB that can be incorporated in future proof pension design as well. The paper therefore concentrates on this aspect and should be read in conjunction with papers with a DC focus, that have been and are being developed by PensionsEurope.

Based on the experiences of countries with DB systems, demographic developments and the challenges of DB systems in the current economic, financial, and labor market, this paper elaborates on the necessary features of a good pension system; these are 1) adequacy, 2) sustainability, 3) reliability and 4) efficiency.

The objective of workplace pensions is to ensure that people are provided with a decent income in retirement (adequacy). While it is difficult to define adequacy, in general one could say that adequacy comprises a good financial outcome for beneficiaries. Adequacy also depends on the level and length of contribution; the earlier one starts to contribute to a pension plan, the better the outcome in the end. Risk sharing can help to improve the welfare of people. A long-term investment strategy helps to maximize the risk/return profile in order to increase the pension outcome at the time of retirement of a person. Pension adequacy needs to be embedded in a tax framework that incentivizes people to save for their retirement and employers to offer workplace pensions.

Sustainability has to be supported by a good supervisory framework seeking a balance between protection of beneficiaries, prudential supervision and the need for pension plans to invest in return seeking investments. Another important element of sustainability are accounting rules which take into account the long-term nature of pension plans. The sponsor of the pension plans should be able to meet its promises and make the required level of contributions. Sustainable pensions are achieved when the inflow to the pension plan is consistent and spread over time. Sustainability also needs fiscal stability.

Reliability is a feature that helps to increase trust in a pension plan. It is based on good governance, where all stakeholders have a say. If people are financially literate, they will better understand what is at stake with their pension planning and they are empowered to take the right decisions. Other important elements are transparency and communication in order to make people understand what their pension plan does for them. Each pension plan should have some degree of flexibility to adapt to the individual circumstances of participants, leading to more trust in the plan.

With regard to efficiency, a certain level of compulsion helps to ensure that people can benefit from economies of scale, risk sharing and lower costs. Good administration is an integral part to delivering good pension outcomes. Thus, efficient and effective administration is necessary. Cost transparency and containment also contribute to an efficient pension plan. Furthermore, the size of the provider could play a role. The larger the provider, the higher the chance of reaching economies of scale and efficiency.

The design principles mentioned in this paper can be used in the design of future pension solutions. As its application may have a different impact on the stakeholders involved, it is the intention of PensionsEurope to work on a next document that explains how these principles may be applied, including its impact on the employer and the employee as well as the political impact and the impact on the regulator.

1. What is a good and complete pension arrangement?

Elements for a good workplace pension provision

1.1 Overview of European pension landscape

The European pension landscape is very diverse; it is thus difficult to clearly define DB plans. Moreover, what is DC in one country (e.g. Belgium) might not be considered to be DC in another (e.g. Ireland) and a lot of ''hybrid'' plans exist across Europe.

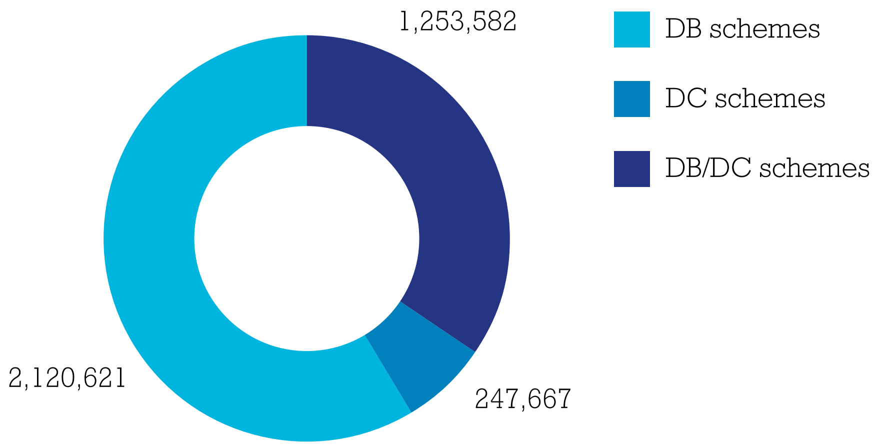
According to the OECD, DB pension plans are '''those in which the level of pension benefits promised to participating employees is guaranteed'' where DC pension plans are ''plans under which the plan sponsor pays fixed contributions and has no legal or constructive obligation to pay further contributions to an ongoing plan in the event of unfavorable plan experience''[1].

While the EU is looking for more investment from such institutional players[2], pension fund assets have constantly been increasing since the financial crisis of 2008. According to OECD Pensions Outlook 2016[3], the ratio of assets to Gross Domestic Product in funded private pensions increased in all OECD countries 2000-2015. The total assets of funded pension arrangements as a percentage of Gross Domestic Product are particularly high in the following European countries: Denmark (205.9%), the Netherlands (178.4%), Iceland (157.7%), Switzerland (123.0%), the United Kingdom (97.7%), and Sweden (76.0%). Several countries will experience further increases in pension savings over the coming decades due to the maturation of relatively recent savings programs, increased coverage and/or increased contribution rates. Meanwhile, as indicated in the latest data by EIOPA, the majority of pension assets are under DB management[4].

> *"The majority of pension assets are under DB management"*

1 See *Private Pensions OECD Classification and Glossary.*
2 See *the EC Action Plan on Building a Capital Markets Union.*
3 See *OECD Pensions Outlook 2016, EIOPA's occupational pensions statistics*, and *PensionsEurope Pension Fund Statistics.*
4 See *2015 Market development report on occupational pensions and cross-border IORPs (PensionsEurope is aware that EIOPA uses different definitions of DB and DC than OECD. Therefore, the figures of EIOPA and OECD are not completely comparable)*

Scheme type - asset amounts (in million €)



Source: EIOPA Fourth Consumer Trends Report[5]

Indeed, in 2014 57% of all Institutions of Occupational Retirement Provision (IORPs) assets under management (AUM) in the EU are invested by DB plans. 34% of assets are managed by hybrid schemes and only 9% are managed by DC schemes. Although it is widely recognized that AUM in DC arrangements are growing fast and that there is a clear focus on the shift from more DB to more DC (and hybrid) schemes, assets under DB management will remain important in the foreseeable future.

"Assets under DB management will remain important in the foreseeable future"

1.2 SWOT-analysis of classical DB pension systems

In the following table we present an analysis providing the strengths, opportunities, weaknesses and threats (SWOT) of classical DB pension systems across Europe (further explained in Appendix 1). Based on the findings, we will set out the features of a new workplace pension design.

5 See *EIOPA Fourth Consumer Trends Report.*

Table: SWOT-analysis of classical DB pension systems

Strengths	Weaknesses
★ Recruitment and retention attractiveness ★ Involvement of stakeholders ★ Predictability for the employee ★ Collective risk sharing ★ Long-term investment strategies and no concentration of market and interest rate risks on retirement date ★ Possibility of longevity pooling ★ Lower long-term costs (where sufficient scale)	★ Reliance on interest rates ★ Accounting rules ★ Funding requirements ★ Dependency challenge ★ Volatility of financial markets ★ Changing preferences of employees due to individualization ★ Evolution of labor markets and work patterns
Opportunity	**Threats**
★ Fostering retirement provision ★ Funding of the Capital Markets Union	★ Regulatory uncertainty ★ EU regulation not neutral ★ Shift to individual DC ★ Political risks

Looking into the strengths and weaknesses of, threats to and opportunities for DB pension provision, one could conclude that future-proof workplace pensions should not entirely move away from a pure DB system to a pure DC system. Rather it makes sense to maintain the strong elements of DB and to combine them with strong elements in the DC world in order to find a balance between the two extremes. A good and complete pension arrangement should be based on features such as collectivity (whilst allowing individual choices to be made), risk sharing (whilst ensuring that there are no undesired intergenerational value transfers) and providing individuals with certain responsibilities (if so desired). It should also be supported by good governance and disclosure to the extent that the individual is placed in the right situation to execute any responsibilities. As part of providing good pensions for individuals, workplace pensions should be tailor-made and fit in the different national economic, cultural and historical fundamentals within the Member States.

1.3 Features of the design of a good and complete pension arrangement

The main objective of a good and complete pension system is to provide for adequate retirement income. At the same time, pensions have to be sustainable, reliable and efficient in order to provide for good outcomes in the future. In the following table we look into these objectives while completing them with specific design principles that have to be fulfilled to attain these objectives.

Table: Pension objectives with their specific design principles

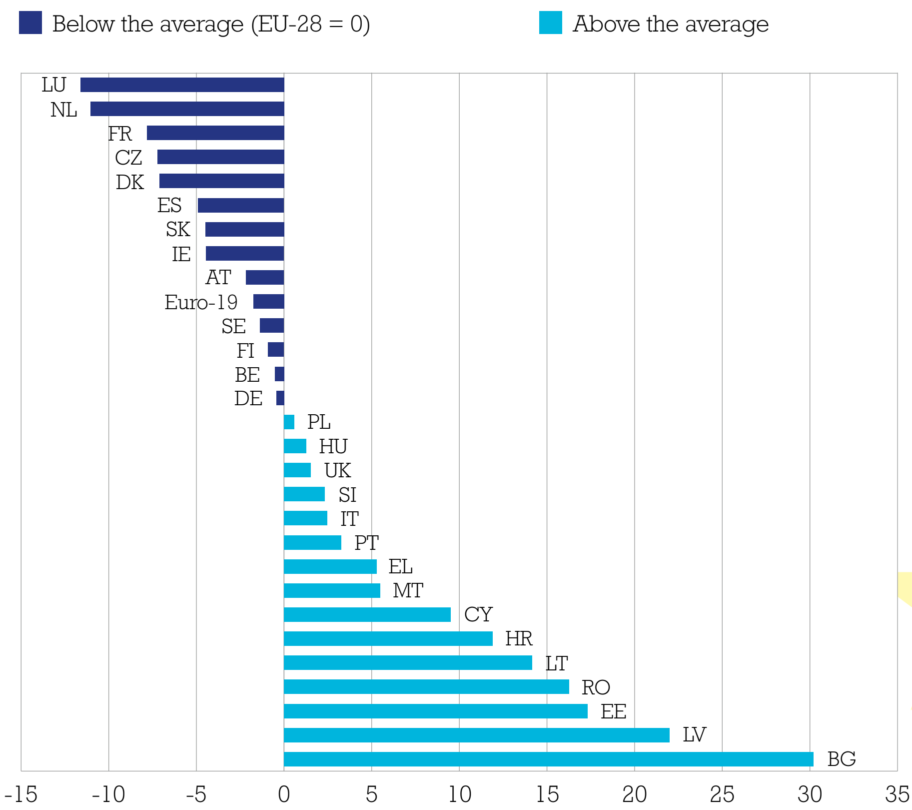
Adequacy	Sustainability
★ Good financial outcome for participants and beneficiaries ★ Level of contribution ★ Level of risk-sharing ★ Long Term Investment strategy ★ Tax framework	★ Good supervisory framework ★ Accounting rules ★ Sponsor health ★ Pension age/length of the working period ★ Fiscal stability ★ Size of the provider ★ Level of risk sharing
Reliability	**Efficiency**
★ Good governance ★ Financial literacy ★ Level of transparency ★ Level of flexibility	★ Level of compulsion ★ Operational excellence ★ Level of costs

These objectives (adequacy, sustainability, reliability and efficiency) of a good and complete pension arrangement are now described in more detail.

1.4 Adequacy

The notion of adequacy depends on the (different) concepts of pensions in the Member States. Adequacy can either mean the maintenance of a specific replacement ratio in face of declining state pensions in order to avoid old-age poverty or allowing beneficiaries to lead a decent life after retirement with a regular flow of income from different sources. In this sense, workplace pension provision adds an additional layer of adequacy for future retirees. It helps to lower the pressure on public pension systems due to demographic ageing of the society. In the table underneath, an overview is given on what adequacy in the different Member States of the EU looked like in 2014:

Figure 1: Percentage of population aged 65 and above at-risk-of-poverty or social exclusion, 2014



Source: Eurostat, EU-SILC. Data extraction date: 15 April 2016.

Notes: data standardised (EU-28=0), light blue (on the right) - above EU-28 average, dark blue (on the left) - below EU-28 average

The table shows that countries with a high coverage of supplementary pension systems provide for more adequate pensions for their beneficiaries (e.g. the Netherlands and Ireland) than those countries with low or no coverage of supplementary pensions (e.g. the eastern and southern European countries), which are identified by means of the red bars).

1.5 Sustainability

According to the European Commission, sustainability means: ''the fiscal and financial balance between revenues and liabilities (and the ratio of workers/contributors to pensioners/beneficiaries) in pension plans[6] (...)''.

Sustainability could be looked at from a macro-economic point of view: it means the sustainability of all the different sources of retirement income, including public pension provision, supplementary pensions and private or personal pensions. PensionsEurope suggests that sustainability should also be considered from a micro-economic point of view: it's about future-proof workplace pensions. If beneficiaries know that their workplace pensions are able to live up to set ambitions, they will also trust the pension providers more. In this sense, sustainability means financial soundness and embraces good governance through fit and proper risk management and a good supervisory system to frame the activities of workplace pensions.

Sustainability is closely linked to adequacy and cannot be seen in isolation. Improving sustainability of pensions cannot mean that the adequacy for future pensioners will be endangered.

1.6 Reliability

If sustainability of workplace pensions increases the trust of beneficiaries, so does reliability. Reliability of workplace pensions means that beneficiaries can expect their workplace pensions to perform according to the objectives set. Thanks to existing security mechanisms in collective workplace pensions or by means of pension protection schemes (e.g. PSVaG in Germany), beneficiaries can rely on a certain level of pension income even if the sponsor employer goes bankrupt and cannot finance the promise any longer. Reliability also implies that the risks taken in the pension plan are either decided upon by the beneficiary and/or are properly managed through the associated governance structures. Finally, a reliable pension plan contains a high degree of transparency through good and comprehensive communication and a clear indication of costs (if relevant) for the beneficiary.

1.7 Efficiency

The last important objective of good workplace pensions is efficiency. PensionsEurope contends that collective pension systems would be the most efficient and cost-effective option for the beneficiaries/employees. Employer-supported pension arrangements do not represent competing businesses, but function as part of the total pay package in the labor market. Furthermore, workplace pensions in pension funds are free of distribution costs. The pension package is an attractive benefit as the employee can take advantage of the buying power and expertise of the employer/fiduciaries, risk-sharing and lower administrative/acquisition costs than he/she could otherwise negotiate as an individual.

Economies of scale are also an increasingly important element to ensure adequacy of governance and efficiency in delivery.

In the following chapter the four main objectives of future workplace pension solutions are further elaborated through design principles belonging to each of the pension objectives.

6 See *European Semester Thematic Fiche Adequacy and Sustainability of Pensions.*

2. How to design good pension solutions?

The way forward: design principles for good pensions in Europe

The features which support the principles described in this chapter have been included for the benefit of both Member States as well as pension providers' consideration. Using these design principles will lead to a good and complete pension arrangement in Europe.

2.1 Design principles of the objective of adequacy

★ **Good financial outcome for beneficiaries**

A good pension outcome is not just the result of occupational pensions. Indeed, social security and other multiple sources of income after retirement (such as housing and non-pensions savings) also play a major role. Governments therefore need to ensure a certain level of income from the first pillar, i.e. by encouraging greater levels of older age workforce participation and more clearly communicating the level of benefits the first pillar can provide. In addition, encouraging sufficient private savings is essential. An effective workplace pension plan must be attuned to changes in life expectancy and prepared to adjust retirement ages accordingly. It's important to achieve a sufficient pension level from a balanced multi-pillar system to provide a good standard of living after retirement for all. Member States have different forms of multi-pillar pension systems including (funded statutory) 1st pillar bis pensions in some countries that fall under the coordination of the social security systems (Regulation 883/04). A key factor in achieving an adequate income in retirement is the contribution that is made to the scheme (by both participants and sponsors). Starting early with accruing pension entitlements can make a significant difference to retirement outcome. The investment policy and investment return that is achieved during participation in the scheme are other major contributors to the overall outcome.

★ **Length and level of contribution**

Adequacy and a good pension outcome also depend on the level and the amount of time contributions are paid into a pension plan by the employer and the employee. The earlier people start to save for their retirement, the higher the pension outcome will be. Therefore, it is important that there is some sort of auto-enrolment or compulsion in order to ensure that people start to save for their pensions right away at the start of their career.

★ **Level of risk sharing**

Collective pension systems allow for sharing of risks such as longevity, interest rate, investment risk and invalidity and/or survivors' pension. Economic theory shows that sharing risks with different generations in pension arrangements could improve welfare. However, intergenerational pension contracts limit opportunities for individual choice in particular regarding investment strategies.

★ **Long term investment strategy**

In line with the OECD renewed "Core Principles of Private Pension Regulation"[7], investments of pension providers should be aligned with the specific attributes and liabilities of a pension plan and the institutional and market environment in which it operates. The provision for IORPs to invest according to the "prudent person rule" set out in the IORP I Directive is maintained in the IORP II Directive. The host Member State may no longer impose additional investment rules on IORPs carrying out cross-border activities. This facilitates the organization of investment management and does not undermine the protection of participants and beneficiaries, because it is matched by strengthened governance and supervisory rules. At the same time, one has to realize that in aligning investments with liabilities a delicate balance between return seeking investments and minimizing risks has to be sought.

Furthermore, in the context of the Capital Markets Union (CMU), pension funds have been invited to make investments in order to boost jobs and growth across the EU. This requires long-term investments in alternative assets such as infrastructure and innovation in designing new asset classes, although pension plans need to have regard to their liquidity needs in doing so. Establishing a cross-border investment-friendly tax environment by removing unfair tax treatment, mainly in the withholding tax area, and introducing tax incentives are essential to boost institutional investments in the EU and ultimately to build the CMU.

★ **Tax framework**

Promoting occupational pension plans needs a tax framework which is both equitable and sustainable. This is both in the interest of society at a macro level and of the beneficiary at the micro level. At societal level, occupational pensions help to alleviate pressure on the public budget. At individual level, people should be incentivized to save for their retirement if there is a favorable tax treatment to do so. The ideal way of promoting occupational pensions is to exempt contribution, to exempt accumulation including the returns on investment and to tax the pensionable income (also known as EET system). PensionsEurope has been supporting the European Commission communication of 2001 on cross-border pension tax obstacles[8] calling for a broad acceptance of the EET principle taxation, considering that exempting contribution is key to increased coverage and that 13 out of the 28 EU Member States already apply a variant of the EET regime to funded private pensions plans[9].

"The way forward: design principles for good pensions in Europe"

7 See *OECD 2016 Core Principles of Private Pension Regulation.*

8 *COM (2001) 214*: Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee - The elimination of tax obstacles to the cross-border provision of occupational pensions.

9 *OECD 2016 report* Stocktaking of the tax treatment of funded private pension plans in OECD and EU countries.

2.2 Design principles for the objective of sustainability

Adequacy and sustainability of pensions are closely interlinked. Without sustainability it will be difficult to achieve adequacy. Therefore, sustainability is a pre-condition for adequate pension outcomes.

★ **Good supervisory framework**

The promise of a pension plan is made against the background of the national and international supervisory frameworks. The pension plan should be subject to appropriate regulation including prudential regulation, communication requirements and sufficient protection for pension plan participants and beneficiaries.

★ **Accounting rules**

Investments aimed pension provision with long-term horizons requires different treatment than purely day-to-day transactions. To encourage sponsoring by the employer, international accounting standards should aim to achieve a fair balance between preserving transparency for investors through the correct presentation of liabilities, while not discouraging companies from providing DB pensions. Pension disclosures should include the cash contributions that a corporate sponsor is committed to.

★ **Sponsor health**

In order to achieve sustainable pensions, it is also important that the sponsor (i.e. employer) has enough means to keep up with promises on contributions and or pension outcomes in the case of a DB plan. There has to be either a pension guarantee fund to back any shortfall of sponsor contributions where the sponsor is unable to make it up itself (i.e. UK and Germany), or the system has to be stable in itself with a possibility of adjusting contributions, adjusting pension accrual, adjusting indexation or decreasing pension benefits (i.e. NL). These pension security mechanisms are of utmost importance for the sustainability of pensions.

★ **Pension age / length of the working period**

Sustainability of pensions also depends on the pensionable age as well as on the length of the working period in line with a long enough contributory period with regard to adequacy. The longer people are paying into the system, the more sustainable and adequate their pensions will be.

★ **Fiscal stability**

Sustainability also depends on fiscal stability within the environment in which a pension provider is acting. Pension provision and the surrounding services used by pension providers operating on a non-for-profit basis should be tax exempt in order to avoid any additional cost burden for the beneficiaries.

★ **Size of the provider**

An important design principle for sustainability could also be the size of the provider. The larger a pension provider the greater the economies of scale, efficiency, financial stability and possibility of cross-border activities.

★ **Level of risk sharing**

As mentioned above, collective pension systems allow for sharing of risks such as longevity, interest rates, investment risk and invalidity and/or survivors' pension. Economic theory shows that sharing risks with different generations in pension arrangements could improve welfare and helps to make a pension system more sustainable. However, intergenerational pension contracts limit opportunities for individual choice in particular regarding investment strategies.

2.3 Design principles for the objective of reliability

★ **Good governance**

As stated in the recently updated OECD Core Principle on Private Pension Regulation[10], pension governance should be guided by the overriding purpose of serving the best interests of plan participants and beneficiaries and ensuring the soundness of pension entities. The way governance is organized influences the level of reliability. Pension funds and pension entities therefore should have appropriate controls, risk management, communication and structures that encourage good decision making, proper and timely execution and regular review and assessment. At the same time, one has to realize that there's a trade-off between increased transparency and costs triggered by good governance.

With the IORP II adoption, the modernized legislation will make pension funds better governed and more transparent. These principle-based rules will strengthen governance while taking into account the diversity of occupational pension systems across the EU and governance structures already implemented at national level such as trustee based solutions / co-determination / involvement of the employers and employees/beneficiaries. Good governance might also be pivotal considering the growing importance of FinTech applications in financial services, including pensions.

10 See *OECD Core principle on Private Pension Regulation.*

★ **Financial literacy**

Reliability can be increased by strengthening financial literacy of participants and beneficiaries of workplace pension plans. For most people, pension provision is likely to be the most significant component of their savings over their working lifetime. However, it is often difficult to engage people on the topic of pensions even when there is a trend towards reduced state benefits in Member States. From an employee point of view, it would be helpful if communication tools by pension providers conveyed information in a consistent manner. Communication should be simple, succinct and appropriate for the participants and beneficiaries.

★ **Level of transparency**

Good information and communication about a plan makes it more attractive and increases levels of participant engagement. Comprehensive communication with the participants and beneficiaries is also important in DB plans, because many of these schemes nowadays have more flexibility and individual choice than they used to in the past. The IORP II Directive requires IORPs to provide more information to their participants and beneficiaries. IORPs shall draw up a concise 'Pension Benefit Statement' (PBS) containing key information for each participant. PensionsEurope agrees that a PBS might be a useful addition in communicating with plan participants, but also notes that numerous initiatives on information disclosure have taken place at Member States' level and that some of them are moving towards more simplified, understandable, and layered information.

However, at the same time there might be a trade-off between clarity, simplicity and understandability on the one hand and a desired level of accuracy of information on the other hand.

★ **Level of flexibility (flexibility versus individual choice)**

Each collective pension plan should have some degree of flexibility to allow participants to manage their personal and financial circumstances. An appropriate level of flexibility increases the trust participants have in their pension plan; that the scheme fits to the needs of the participant and that it can control – to a certain extent – the benefits provided. It is up to the social partners/trustees to decide with the relevant stakeholders on the possibility of flexible elements in the pension plan. Any flexibility offered needs to be neutral from an actuarial point of view.

It's a misunderstanding that there cannot be flexibility in DB-schemes. In particular in the de-cumulation phase flexibility in DB-schemes is certainly possible: e.g. (i) high – low construction in the pay-out phase i.e. a participant can draw more pension in the beginning of retirement and less later or vice-versa; (ii) a lump sum payment of part of the pension at retirement, (iii) allowing participants to phase out their work-life and enjoy a part-time pension payment while continuing to work at reduced hours; and (iv) allowing participants to transfer DB rights to an alternative vehicle which might provide additional de-cumulation options.

2.4 Design principles for the objective of efficiency

★ **Level of compulsion**

A pre-condition for the strength of pension systems is high participation through for example compulsory participation or auto-enrolment mechanisms. Participants will benefit from economies of scale leading to more efficiency and lower costs. Compulsion can be organized at the level of an employer (or sector) being obliged to offer a pension plan to its employees. But it can also be organized at the level of employees being obliged to participate in the scheme the employer (or sector) is offering. Default structures of opting-out or auto-enrolment in a pension plan might also be useful in this respect but would require clear communication to employees.

★ **Operational excellence**

Good administration is an integral part of delivering good pensions outcomes. Efficient and effective administration can deliver powerful benefits to participants and beneficiaries in terms of lower costs and greater accuracy. As administrators are often responsible for participant communications they need to ensure they are extracting the correct information to give to participants and beneficiaries. Pension administration and investment policy should be executed by professional, experienced and knowledgeable people. As a consequence, participants and beneficiaries can rely on the governance in place to take the decisions in their best interest.

★ **Level of costs**

Costs and fees are clearly an important consideration in the delivery of efficiency. Fees levied by asset managers and the costs of transactions involved in investing and managing pension fund assets influence the returns that pension funds achieve. Good value for money does not simply equate to low cost, as it's ultimately about the highest net returns and the provision of the best outcomes for participants and beneficiaries. Higher costs could pay for good quality service and financial advice that may be beneficial, leading to better results.

Transparency of costs is hence vital to help employee representatives / trustees and sponsors in their decision-making on scheme offerings. Several countries engage in initiatives to increase the transparency of (administrative) costs. This enables comparison with other types of schemes. It pushes pension providers and asset managers to disclose the costs for pension administration and asset management.

APPENDIX 1

What is the DB state of play? A SWOT analysis of DB pension provision

DB strengths and opportunities

Funded DB plans have several advantages over alternatives:

- **Recruitment and retention attractiveness**

  The IORP II Directive acknowledges that IORPs (Institutions for Occupational Retirement Provision) have a social purpose[11]. Indeed, DB plans originated from the idea that a pension is an important collective labor benefit with a social function. It is not merely a financial product. When long-life careers in one company were still very common, the main idea was that the employer had a moral "duty of care" for its employee. Today, the existence of a good quality pension plan has proved valuable in giving employers a competitive edge in recruiting and retaining employees when facing a tightening labor market. Many DB plans provide for additional benefits such as disability, pension survivors, death or orphan benefits and thus become even more appealing to employees.

- **Involvement of stakeholders**

  DB plans are often governed by a fair representation of employers and employee representatives or a board of trustees. The board members/trustees undergo specialized training and, in some countries, are scrutinized by supervisory authorities in order to make sure that they are fit and proper for their function in a board. The employees feel empowered by being represented in the board and on equal terms with employers. In some countries retirees can also be involved in the governance structure. Pension is usually a shared responsibility of the social partners, especially due to the inherent guarantees.

- **Predictability for the employee**

  DB plans provide employees with a high degree of certainty with regard to their prospective level of retirement income irrespective of how long they live and dependent on the way the risk is shared.

- **Collective risk sharing (and/or solidarity between generations)**

  Collective DB systems allow for sharing of risks such as longevity, interest rate, investment risk and invalidity and/or survivors' pension. Often DB plans place the investment risks associated with market fluctuations upon the sponsor (employer) instead of the employees. It is also possible in some countries that the investment decision making will lie with those responsible for the fiduciary management of the pension fund, which includes employer and employee representatives and is assisted by advisers in determining the investment strategy.

11 See Recital 32.

- **Long-term investment strategies and no concentration of market and interest rate risks on retirement date**

  Market, interest and longevity risks are distributed collectively in DB plans and it is possible to spread those risks over a longer period of time. DB plans are able to take advantage of the enhanced investment returns that come from maintaining a balanced portfolio over a long period of time. Also continuation of taking investment risk after retirement is possible, leading to an expected improvement of the pension result in the long term.

- **Possibility of longevity pooling**

  Paying pensions from the scheme rather than buying out annuities externally at retirement date means that the scheme can benefit from longevity pooling.

- **Access to much more asset classes**

  Typically, DB plans can in principle access much more asset classes, improving diversification including non-liquid investments due to their long-term investment horizon, allowing such schemes to collect non-liquid access premia.

- **Lower costs (where sufficient scale)**

  In a DB system, the costs of the pension system fall largely on the employer/sponsor. Costs, apart from contributions, imply both administrative costs for the execution of the pension contract as well as investment costs. Through economies of scale and cooperation with external service providers, costs can be kept low. In some countries further consolidation is necessary to achieve such economies.

The important and growing role of workplace pensions is highlighted by the European Commission[12] and by the OECD[13] as follows (applying to DB-, DC- and hybrid solutions):

- **Fostering retirement provision**

  Longevity improvements, low birth rates and the transition into retirement of the baby-boomers have far-reaching economic and budgetary consequences on public finances in the EU. All Member States with Pay-As-You-Go pension systems are confronted with cost increases, which mean a growing pressure on public finances and/or social security systems. According to the OECD, the old-age dependency ratio[14] will increase from 28% in 2015 to 51% in 2050. This burden is falling increasingly on younger generations.

  The impact this will have on public schemes could be offset or mitigated by extending the time over which pensions are accrued i.e. the time spent in employment and reducing the period for which they are paid. In many Member States reforms have already been implemented leading to an increase in retirement ages in order to keep pensions sustainable. These are steps in the right direction, but in some countries there remains a growing risk that future pensions will not be sufficient. Encouraging individuals to save will help reduce the reliance on means-tested first pillar benefits[15]. Europe needs more funded pensions to cope with the challenges. Workplace pensions are, in general, the most efficient way of saving for pensions to supplement State provision and DB pension plans have relied on the strengths detailed above.

12 See EC *Annual Growth Survey 2017.*
13 See OECD *Pensions at a Glance 2015.*
14 OECD defines the demographic old-age dependency ratio "as the number of individuals aged 65 and over per 100 people of working age defined as those aged between 20 and 64". See *Pensions at a Glance 2015: OECD and G20 indicators.*
See also See *EC 2015 Ageing Report.*
15 See *Pensions at a Glance 2015: OECD and G20 indicators.*

Funding of the Capital Markets Union

Pension funds are 'natural' long-term investors, due to the long-term nature of many of their liabilities. Under the right conditions, the capital in pensions can contribute to the development of 'the real economy' and thus contributes to growth and jobs by making long-term investments. Thanks to pension funds' countercyclical behavior, they can contribute to financial stability, as they did during the last financial crisis providing that the risk assessment is made on a long term basis.

DB weaknesses and threats

Over recent decades the DB landscape in Europe has experienced a transformation from pure DB plans based on final pay to all sort of different schemes (career average, CDC, hybrids, IDC). This can be explained by the following challenges:

Reliance on interest rates

A prolonged low interest rate environment can put funding ratios of DB plans under pressure and increase the price of annuities. This can mean lower pension benefits and/or increased contributions and sponsor's costs (employers). In turn, pension funds that required sponsor support to maintain level of promises may have negatively impacted sponsor's growth and the wider European economy. It is, as yet, unclear how this and the effects of currently experienced Quantitative Easing (QE) will play out in the coming years[16]. DB pension funds might become involved in the "search for yield" in order to match the levels of returns promised to beneficiaries when interest rates were higher.

Accounting rules

The International Financial Reporting Standards (IFRS) are an important driver for the closure of DB plans; the mark-to-market approach increased the volatility in the balance sheet of the sponsoring company and, arguably, has not necessarily given a realistic long-term view of the value of the liabilities. Under IAS 19 DB plans are required to include technical provisions which take account of the design of the promised pension benefit as well as longevity and investment risk. Accounting for DC plans referred to as current expense only is notably different, since no long-term provisions apply (because the employer has not promised a given benefit level).

Funding requirements

Promising a benefit means that, in some countries, DB plans might have to hold high (solvency) buffers of capital to secure their promises. Furthermore, it means that investments in high-risk asset classes is only possible to a limited extent, if at all, whereas investment in risky asset classes could increase the future retirement income on the one hand and could contribute to investment in the real economy on the other hand.

Dependency challenge

The European societies are ageing and the number of working people that contribute either directly or through their employers to DB systems is shrinking in comparison with retirees who already draw retirement benefits. Depending on the design of a DB plan, this can put pressure on the respective pension plan as the ongoing contributions have an impact on the total asset allocation and the financial position of the pension fund.

16 The current QE by central banks leads to lower funding ratios for DB-schemes. As a consequence, sponsors and active participants could feel the burden of higher contributions and lower pension accrual (both for DB and DC). See also *position paper of the EIOPA Occupational Pensions Stakeholder Group on QE.*

- **Volatility of financial markets**

  Financial markets tend to be volatile as do financial market instruments. Pension plans have to set the investment policy commensurate with the risk appetite of all the stakeholders involved. Balancing risk/return requirements of the various age groups (the younger one is the more risk can be taken) in a consolidated investment policy may lead to, by a varying degree, less optimal result for each group.

- **Changing preferences of employees due to individualization**

  There are societal developments towards a greater focus on the individual as being responsible for his retirement provision and more choice. Moreover, intergenerational solidarity is increasingly challenging in some Member States and some people - who feel that they are overburdened - would like to switch to more flexible, individualized pension plans that provide more individual choice. In its most radical form, the risks are completely shifted away from the sponsor towards the employee.

- **Evolution of labor markets and work patterns**

  New categories of workers such as self-employed workers and atypical workers are on the rise in line with the recent increased flexibility characterizing the evolution of the labor market. According to Eurostat, in the EU about one in ten persons who work (10.3 %) is self-employed without employees (own-account workers), and about one in twenty (4.1 %) is an employer (self-employed with employees)[17]. Since lifelong careers at only one employer are becoming increasingly rare, portability solutions for DB schemes should be promoted.

"What is the DB state of play?"

In the foreseeable future, DB plans will be facing the impact of the following threats:

- **Regulatory uncertainty**

  The design of pension systems exclusively falls under the competence of the Member States and the European Union mainly supports and complements the Member States' activities through policy guidance. This includes sharing of best practices and mutual learning, but also the coordination of social security legislation and specific acts on supplementary pensions. The recently adopted IORP II Directive aims to ensure that IORPs use sound management processes and are run by fit and proper people who communicate essential information on pension rights to scheme participants and beneficiaries. It also aims at facilitating cross-border provision. Progress has also been made in eliminating barriers that can result in people losing out on their pension entitlements when they relocate to another country. The Mobility Directive which will be implemented in the Member States by 2018, sets some minimum requirements for the acquisition and preservation of pension rights of people who go to work in another Member State. PensionsEurope welcomes the modernized rules for pension funds, but now calls for a period of legislative calm in order that pension funds can concentrate on delivering adequate, safe and affordable pensions and retirement provision for their participants and beneficiaries.

17 See *Eurostat Employment by professional status, persons in employment aged 20-64, 2015.*

★ **EU regulation not neutral**

The European regulation on occupational retirement provision usually applies to both DB and DC schemes, but its impact/repercussion is not the same for both types of scheme. That is the case, for instance, with the recently adopted information requirements in the IORP II Directive. Equally, the key provisions of the Mobility Directive impact mostly DB plans: the preservation of pension rights of deferred members as well as waiting and vesting periods are issues in DB plans, while they overall do not matter in DC schemes.

★ **Shift to individual DC**

The European Commission has now turned its focus to the creation of a Single Market for Personal Pensions and to the establishment of a European Pillar of Social Rights. In addition, EIOPA has initiated work on the development of a cross-border framework for occupational DC pensions. While EIOPA has developed ideas to the detriment of DB-Schemes (e.g. common framework), PensionsEurope calls for reflections on how to promote collective DB occupational pension systems in Europe - for example by the implementation of hybrid schemes that combine the advantages of DC and DB systems for participants and beneficiaries.

The same applies at the national level where most countries are experiencing a continuous shift to DC arrangements[18]. This changing landscape can be explained by the cost repercussions due to the challenges for DB pension plans detailed above, but also by several ongoing reforms which are impacting DB pension provision[19] to a lesser or greater degree

★ **Political risks**

Uncertainties raised by Brexit and other changes in the political landscape, the rise of populism and nationalism across Europe and short termism reforms will impact European dynamics and thus have more or less direct consequences on DB pension provision in the future. This could have an impact on both investment strategies and returns as well as on a more political level with one of the major occupational countries leaving the EU. As a consequence, the voice of a fierce defender of less influence on pensions will be less important. This might lead to more European influence on pensions and more harmonization of pension policy.

18 Transfer of DB affiliated participants to new DC schemes (NO for employees over 52 years old, SE following a long period of transition). In some countries, DB arrangements are closed to new participants (NO, SE) and even more recently to future accrual of benefits (UK).

19 Several other reforms of the regulatory framework for occupational pensions currently under discussion might - to a lesser or greater extend still to be determined – have an impact on DB plans. Amongst them, the expected introduction of a new pension vehicle in SE and FR; the possible decrease of the level of tax relief on employee contributions and a possible wider reform of the taxation system in the UK; the discussion in the UK to introduce risk-sharing/defined ambition arrangement as a form of DB loosely based on the CDC NL model (see annex); the introduction of further capital requirements at national level in NO and SE; the introduction of new pensions contracts with digressive accruals in NL; increasing the retirement age (BE and NL) and restricting early retirement age in BE; further decreasing of tax exemption on annual pension accrual in connection with a maximum salary (100K) in NL.

APPENDIX 2

Examples of good practice of DB plans

Canada target benefit plans

Target benefit plans[20] have been established in a number of provinces of Canada to provide benefits which can be viewed as ''soft guaranteed'' benefits as distinct from ''hard guaranteed'' benefits in what may be viewed as a conventional DB pension plan. Unlike a ''pure'' defined contribution pension plan, the benefits in a target benefit plan would be expressed in conventional DB form.

In other words, a pension which accrues by reference to years of pensionable service and which is payable from a normal retirement date (e.g. age 65) for the life of the member and with certain attaching survivor benefits.

Dependent on plan design, the benefit may, however, take the form of a career average earnings benefit structure. So, for example, the member might accrue 1.67% of pensionable earnings for the particular plan year in question. The amount calculated for each plan year would then have the benefit of some element of inflation protection in the period before coming into payment and would then have some element of inflation protection once in payment.

The level of plan benefits is not guaranteed and could decrease or increase, depending on the actual experience of the plan relative to the assumptions made.

Collective Defined Contribution (CDC) plans in the Netherlands

In the Netherlands, so-called Collective Defined Contributions (CDC) schemes have appeared in the past. In the Dutch occupational pension system, CDC pension agreements are legally a form of DB (DB) schemes. In a CDC pension agreement, entitlements accrued in past years are treated as regular DB pension entitlements. However, the contribution rate (or premium) is set at a fixed level, mostly for several years. This means that it is not possible for the pension fund to increase the contribution rate or to ask for a lump sum to generate an additional inflow of contributions, for instance to increase buffers. Moreover, if the fixed contribution rate is too low to cover the level of new pension accrual in a given year, the level of new pension accrual is adjusted downwards and the contribution rate does not change. There is an ambition for a certain level of pension accrual. Thus, certain risks are shifted to the employee, requiring transparent disclosure of the risks involved. In standard DB agreements, the contribution rate would increase. In the more recent pension discussion, the Netherlands is (slowly) heading towards a system in which the best of the DB world and the DC world are combined. This means that the risks are still shared in a collective system while the system is shock resistant (financial and demographic) and the transition from an old DB/CDC system towards a new system with collectively managed personal accounts and/or the pension ambition contract happens in a smooth way. An important element in any adjustment of the DB and the DC world is ultimately the communication to the scheme members.

20 These are also referred to as shared risk plans in the Canadian context.

Supplementary pensions of the public sector – In spite of reforms still a sustainable DB-scheme

Germany is perhaps one of the remaining countries where supplementary workplace pensions are still DB plans although DC elements are becoming increasingly important. This is also true for the public sector pension plan which currently has roughly 5 million insured persons and more than 2.5 million pensioners. The determination of the public sector pension benefits through collective agreements is based on a long history, starting in the first half of the 20th century. In 1967 – still in a period of economic welfare – the social partners of the public sector introduced a very generous DB top-up scheme[21].

However, this occupational pension plan faced severe problems, especially at the end of the 1990s. Indeed, since the contributions were expected to double within a 10-year horizon, the social partners of the public sector therefore decided to close this top-up scheme and replace it by an ordinary career average plan with effect as from 1 January 2002. The contributions are calculated as a percentage of the salary and converted into pension units with age-related conversion factors. The conversion factors are calculated with a discount rate of 3.25% during the active phase and of 5.25% as from retirement. The total amount of pension units, which the employee acquires during the years of service in the public sector, are multiplied with a predefined amount of 4 Euros. This sum constitutes the future occupational pension.

The new point-based occupational pension plan still constitutes a DB-scheme (since the later sum of pension points are guaranteed), however with DC-elements (amount of pension points notably depends on the contributions during an employee's career). Another main and singular feature of this reform was the transfer of all acquired pension rights of the former top-up scheme into the new pension plan, which affected more than 9 million persons. Thus, the pension institutions do not need to continue administering two pension plans for several decades. Furthermore, all concerned employees – existing members and new entrants – shared the burden of the reform in terms of intergenerational solidarity.

At a mid-term horizon, the level of the new point-based occupational pension plan will be around 20% lower than the former top-up scheme. The employees, however, can compensate for this lack by means of voluntary additional contributions which benefit from tax relief. In spite of this lower level, the public sector occupational pension plan is still a relatively generous DB-scheme (with DC-elements). Being based on a collective agreement, this pension plan covers almost 100% of public sector staff including low earners and SMEs, which do not usually benefit from occupational pension plans in Germany. Furthermore, the average benefit level of this scheme is 30% of the average old-age income and hence constitutes a real and strong second pillar. Additionally, most of the contributions are paid by the employers, which is not self-evident in the occupational pension landscape in Germany. And finally, the pensions are administered by public sector pension institutions which cater to between ten thousand and 1.8 million insured persons. Due to this size, these pension institutions profit from economies of scale which are passed down to the pensioners by means of higher pensions.

21 According to that pension plan, an employee received an additional workplace pension covering the difference between the benefits of the state-run first pillar scheme and the very generous pension of a civil servant, which – at that time – foresaw a replacement rate of 75% of the gross income of the last 3 years of service.

Setting up a Defined (oriented) contribution plan with guaranteed minimum in a German pension fund

With Germany having a strong focus on DB plans, Bosch started with classic final pay systems that stayed prevalent over decades. With the Bosch Group growing nationally and internationally the final pay schemes also grew and started to diverge between different sites, undertakings, employee groups etc. resulting in a fragmented landscape of DB plans that became increasingly difficult to manage from the perspective of efficiency, legal governance and employee value. During the 1990´s they found over 90 different DB plans within the Bosch Group and decided to go for a change aiming for a solid and waterproof plan design that provides greater efficiency and a solid mix of security and long-term return from both the perspective of the company and the employees.

In 1999, Bosch forged a collective agreement *(Kapitalvorsorgeplan)* with the employees' representatives on the corporate level to shut down the 90 local final pay plans and transform them into a single corporate-wide plan that was still a DB plan but no longer relied on a final pay design. The new design was contribution related, building an individual's capital with an inherent guaranteed interest rate with the latter still locating the design in the DB regime. The implementation and financing was at that time still based on book reserves.

Two years later the first German pension fund (Bosch Pensionsfonds) starting with employee contributions was founded and in 2005 employee contributions and employer contributions were merged into a single collective agreement on corporate level *(Bosch Vorsorge Plan)* that integrated them into todays Defined contribution (oriented) plan with guaranteed minimum. Being still a DB plan because of the guaranteed minimum (which equates to a guaranteed interest rate of 0%) this kind of plan design is very close to a defined contribution design incorporating advantages of both worlds. The return on contributions is generated from the investment return of the Bosch Pensionsfonds. Due to the long investment horizon the employees receive good yields without risking funding deficits for the company in case of short-term fluctuations. At the start of the payout period a minimum amount of the nominal contributions is guaranteed by the employer. In the accumulation phase the limited guarantee gives the pension fund more room for an efficient and broad investment strategy without sacrificing risk-bearing capacity. From the employees' perspective the accumulation phase is attractive in terms of investment return without sacrificing security and calculability.

With a new law becoming effective 2016, the Bosch Group and the employee representatives further developed the plan design for the provision of lifetime annuities by stretching the described advantages of the accumulation phase (efficiency, broad investment strategy, risk-bearing capacity) into the retirement phase. With the elimination of the traditional emphasis on insurance-like operations in the retirement phase the lawmaker made way for a prudent person-oriented and principle-based regulation that blends well with the nature of a corporate pension fund that operates not for profit and relies strongly on the cooperation with employee representatives on all levels. Fluctuations in the returns of the pension fund can now be balanced through the use of capital buffers as well as temporary pension reductions in a crisis situation. For security and calculability, a minimum pension is still guaranteed by the employer and is part of the collective agreement with employees' representatives. While the plan design may have moved to an outmost position on the broad DB spectrum it now balances expected investment return, security and calculability into a solid, weatherproof concept that has a good chance to help us organize occupational pensions for another 90 years.

The setting up of a DB plan with a contribution oriented benefit formula by a German Pensionskasse

Due to the provisions of the German Occupational Pensions Act, only pension plans that operate on a DB basis are considered as Occupational Retirement Provision in Germany. (Pure) DC plans are classified as private pensions of the third pillar. Specific hybrid pension plans that include both DB and DC elements, like, for example, defined contribution promises with a guaranteed minimum benefit or contribution oriented pension promises, are designated as occupational pensions by the German Occupational Pensions Act.

The Höchster Pensionskasse VVaG, a German institution for occupational retirement provision (IORP), is providing occupational pensions (lifetime annuities) solely according to a contribution orientated benefit formula and was founded in 1998 as an occupational pension provider for a joint venture entity of two large German companies of the chemical industry that wanted to offer transparent, attractive and sustainable supplementary occupational pensions to their employees. The contribution oriented pension formula provides for those qualities and for the opportunity to offer calculable DBs.

The scheme is funded by contributions of the employer and its employees. The calculation of the acquired retirement benefits is based on the level of contributions paid and executed according to a DB formula equivalent to the age and other biometrical aspects of the respective employee (monthly basis) referring to the event of the payment of the contributions. That leads to a maximum of planning security and transparency for the IORP as well as for the respective employee and also for the employer, who is responsible for the given pension promise because of a statutory liability. Furthermore, such a calculation formula leads to maximum flexibility. The Pensionskasse is designed as a multi-employer IORP. For these reasons, the statutes and bylaws of the Pensionskasse do not stipulate a fixed contribution amount. Every employer is free to decide the level of contributions paid and whether to require employee contributions as long as the level of the employer's contributions is at least as high as the contribution level of the employee. Furthermore, there is no link to any kind of statutory retirement age because the defined calculation formula is designed on a three-dimensional basis. The benefit formula of the scheme in general refers to an age at expiry of financing of 65. The benefits of people that decide to apply for retirement benefits earlier are calculated with a reduction. Employees that decide to work longer will continue to contribute to the scheme and will receive retirement benefits calculated with additional surcharges. Due to tax reasons, people are not allowed to apply for old age provisions before the age of 62. In case of termination of the employment contract, outgoing workers are allowed to continue contributing to the plan themselves or can decide to transfer the capital value of their acquired entitlements to another pension plan (portability).

The Höchster Pensionskasse operates as a mutual insurance association (Versicherungsverein auf Gegenseitigkeit). According to the legal framework of the German Insurance Supervision Act, the Pensionskasse is regulated by its Supervisory Authority which provides a maximum level of co-determination as at least 50 percent of the members of the senior representative body are appointed by the members/their representatives. This arrangement also leads to a high level of transparency in relation to cost. Furthermore, the Pensionskasse is not allowed to charge any acquisition cost loadings for the intermediation of insurance contracts and/or to pay any fees for intermediation or conclusion of such contracts. In 2015, the level of administration costs in relation to the contributions received was about 1 %. Currently, the Höchster Pensionskasse VVaG has almost 500 sponsoring undertakings and more than 145.000 members and beneficiaries.

Examples of good practices for sustainable DBschemes in Ireland

In common with the experience worldwide, DB (DB) schemes in Ireland have faced increasing funding difficulties not only due to the impact of low bond yields and improved longevity but also because of regulatory funding requirements and the impact of pension deficits in company accounts arising from accounting rules.

As a result, the vast majority of companies in Ireland have closed their DB plans to new members, many have closed their DB plans to future accrual of benefit and a significant number have wound up their DB plans. In this regard it should be noted that there is little statutory protection for members in the event of a DB plan winding up other than a limited protection in the event of the double insolvency of the pension plans and the employer. Any legal protection for members will be due to the provisions of the DB plan trust or because of contractual commitments outside of the pension plan. Nevertheless, DB plans are still a very significant part of pension provision. Excluding unfunded public sector arrangements, DB plans represented 62% by value of total pension fund assets of €116bn at the end of 2015[22].

"Examples of good practice!"

Part of the difficulty facing DB plan sponsors and trustees is the statutory funding standard which in particular requires pensions in payment to be funded to the annuity buy out cost and for the funding position to be assessed on an annual basis. This is an increasing problem for DB plans as they mature.

One of the solutions to creating a sustainable DB plan is to include a significant discretionary element to the benefit structure. One example where this has been done is where a scheme had guaranteed pension increases, the trustees applied to the pensions regulator for pension increases to be changed from a guaranteed to discretionary basis. Similarly, revaluation of accrued benefits for employed members to retirement age could be made discretionary. Having such a discretionary element to benefits gives the trustees scope to adjust benefits in the event of favourable or unfavourable experience, greater freedom in the scheme's investment policy and ultimately improve the sustainability of the scheme.

Another solution has been for the employer to make contingent assets available to the DB plan which could be accessed in the event of the scheme winding up in deficit. This provided a "buffer" to the trustees of the DB plan to continue to fund for benefits on a long-term funding basis rather than the more restrictive statutory funding standard.

22 IAPF Pension Investment Survey 2015

Alternative risk sharing approaches in the United Kingdom

The trend of switching to pure DC is strong in the UK, but some schemes have tried alternative, risk sharing approaches:

1. One of the large education sector schemes in the private sector (the Universities Superannuation Scheme) has a benefit structure with an employer contribution rate of 18% and an employee contribution rate of 8%. The Scheme provides a core DB benefit of 1/75 pensionable salary plus a cash lump sum of 3/75, for each year of scheme membership, up to the threshold of £55,000 pensionable salary. Benefits are calculated and "banked" on an annual basis and increase in line with inflation (subject to certain limits around the level of inflation proofing where inflation is in excess of 5%). This is known as the "Income Builder" section of the Scheme.

   12% of the employer contribution above the threshold pensionable salary of £55,000 is paid into a DC section of the Scheme. Employees can make voluntary contributions to this section and if they choose to do so the employer will also match the first 1% of that employee contribution. This section is known as "Investment Builder". On retirement, it is used as a DC pot.

2. Cash balance schemes in different forms are also used by some employers. One example is where the employer and employee each make agreed contributions and the employer guarantees a certain level of returns e.g retail price inflation plus a minimum of 1.5% and a maximum of 6.5%. At retirement the "pot" is used by the employee to purchase an annuity from an insurer or transfer to another arrangement. Thus, the employer takes the risk regarding the guaranteed investment returns and may need to make extra contributions, but may profit if investments perform better than the maximum guaranteed amount. The employee then bears the burden in relation to longevity either through paying the prevailing annuity rate to an insurer on purchasing an annuity, or by bearing the risk that on drawdown, they will run out of money during retirement.

3. Some schemes on closing to future DB accrual have put in place "targeted DC", where the actuary calculates levels of DC contribution designed to deliver the same or a similar level of benefit at normal retirement age. This can result in quite high levels of contribution shared between employer and employee, targeting the desired benefit, but with no legal commitment on the part of the employer to fund the shortfall if investment returns or others assumptions are not borne out in practice.

About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace pensions. Some members operate purely individual pension schemes. PensionsEurope Members are large institutional investors representing the **buy-side** on the financial markets.

PensionsEurope has **24 member associations** in 19 EU Member States and 3 other European countries with significant – in size and relevance – workplace pension systems[23].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people**. Through its Member Associations PensionsEurope represents more than **€ 4 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **25 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

Workplace pensions offer:

- ★ Economies of scale in governance, administration and asset management
- ★ Risk pooling and often intergenerational risk-sharing
- ★ Often "not-for-profit" and some/all of the costs are borne by the employer
- ★ Members of workplace pension schemes often benefit from a contribution paid by the employer
- ★ Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment
- ★ Good governance and alignment of interest due to participation of the main stakeholders

What PensionsEurope stands for:

- ★ A regulatory environment encouraging workplace pension membership
- ★ Ensure that more and more Europeans can benefit from an adequate income in retirement
- ★ Policies which will enable sufficient contributions and good returns

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