PENSIONS FOR AN AGEING SOCIETY

Choices and Solutions

COMITÉ EUROPÉEN DES ASSURANCES

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FOREWORD AND ACKNOWLEDGEMENTS

One of the key challenges facing all EU governments is how to pay for state pensions as the average age of the population rises and the proportion of working people to retired people falls.

The CEA presents the European insurance industry's views and recommendations on how to meet this challenge by encouraging saving in funded private pensions as a supplement to state pension provision.

This report aims to explain the ageing challenge and to demonstrate how life insurers, along with other private pension providers, can help EU citizens save for retirement through both occupational pension schemes (2nd pillar) and individual pensions (3rd pillar).

Due to their expertise in managing longevity risks and asset-liability management, life insurers are well placed to play an important role in the provision of funded pensions.

National governments and EU policymakers have already done much to meet the challenge of ageing but more can, and must, be done.

The CEA welcomes comments on this report and looks forward to discussing it with national and EU policymakers and with those most affected – the citizens of the EU.

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This report has been produced by the CEA Life Insurance Committee. It is the outcome of a collective effort undertaken by the CEA's members under the co-ordination of the CEA Secretariat. ■

November 2005

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EXECUTIVE SUMMARY

The EU Member States are facing a pensions crisis. With life expectancy increasing across Europe and fertility levels declining, the long-term sustainability of public pension systems is coming under increasing pressure. While today there are four people of working age to support each pensioner, by 2030 there will be only two. As a result, if reforms are not undertaken, the cost per worker of providing pensions will double over the next few decades. National governments face some stark choices. In simple terms they must either:

- Keep contributions at current levels but accept that the value of **state pensions will fall**;

- **Increase taxes or contribution levels** to finance PAYG state pensions;

- Substantially **increase the employment rate** in order to increase the number of people contributing to the state pension;

- **Raise the average age of retirement** in order to increase pension contributions and reduce pension costs.

These choices are not mutually exclusive and it is likely that national governments will choose a **combination of them**.

Most of these options involve difficult decisions for governments. Cutting state pension levels or raising taxes is seldom popular. Increasing the employment rate can only be achieved following concerted action. Changes in the age of retirement are likely to be highly controversial. However, there is another way of dealing with the pensions crisis – encouraging voluntary saving in funded pensions.

Indeed, many governments have already undertaken initiatives aimed at encouraging saving in funded private pensions as a supplement to the current Pay As You Go (PAYG) state pensions. Funded private pensions have several advantages:

- By using a mixture of PAYG and funded provision, the cost of population ageing is spread more fairly between the generations;

- While making people save more by means of statutory measures is nearly always unpopular, providing fiscal incentives to encourage people to undertake voluntary saving is usually welcomed;

- Funded pensions provide certainty for those who save in them, whereas state pension provision, exposed as it is to the fiscal constraints of population ageing, runs the risk of being cut back;

- When combined with a PAYG element, they help reduce systemic risk by spreading pension entitlement across both unfunded state provision and funded private provision.

- Funded pension systems contribute to economic growth. By accumulating individuals' savings they provide a source of long-term investment capital for industry.

- If properly encouraged and incentivised, funded pension provision can increase the savings rate, with concomitant benefits for the productive capacity of the economy.

But a complete switch to funded pension provision would be neither feasible nor desirable. So long as today's pensioners have entitlements under the PAYG system, it is necessary to raise funds from the working population. In addition, in order to meet various social policy objectives, most Member States are likely to wish to maintain some PAYG element in the system.

Life insurers play a major role in occupational pension schemes (2nd pillar) and individual pensions (3rd pillar) all over Europe. This is due, in particular, to their expertise in managing longevity risks. For example, annuity products guarantee a specified income until death, no matter how long an individual lives. Insurers also have expertise in asset liability management. This involves ensuring that the assets collected and invested are sufficient to meet the cost of pensions (the liabilities). This, in turn, requires expertise in understanding how long individuals and groups will live (mortality risk) and how their health will be affected by

EXECUTIVE SUMMARY

their age (morbidity risk). Those buying insurance products also benefit from the safeguards provided by the EU's prudential regulations which require insurers to maintain capital reserves.

However, currently, Europeans are not saving enough to ensure they will have an adequate income in retirement. It has been estimated that the shortfall in savings amounts to 456 billion euro per year. Therefore, to help foster the development of funded pensions and ensure that individuals have an adequate income in retirement, the European insurance industry urges national and EU policymakers to:

- Encourage national governments to provide accurate and easily understood information on the actual value of pension benefits each individual can expect to receive from state provision;

- Encourage national governments to develop financial education and improve financial capability related to retirement provision so that individuals will be able to make an informed choice about whether, and how much, to save in addition to state pension provision;

- Encourage national governments to provide effective fiscal incentives with a view to promoting long-term funded pension saving;

- Ensure that the EU and national regimes for consumer protection balance the need to protect consumers with the need to facilitate extra savings in occupational or individual pensions;

- Guarantee fair competition and a level playing-field amongst all operators in the 2nd or 3rd pillar of the pension field;

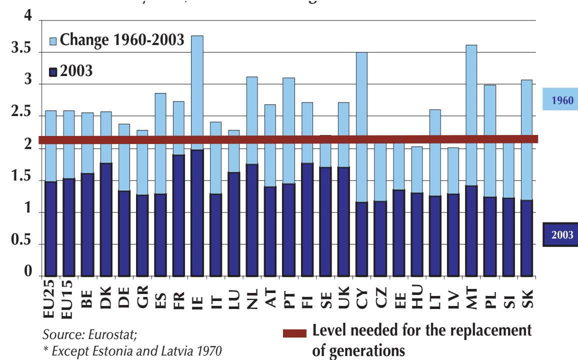
- Make use of the EU's Open Method of Coordination as a forum to monitor the adequacy and sustainability of pensions and share best practice examples of dealing with ageing populations and promoting funded pensions. ■

I. THE DEMOGRAPHIC CHALLENGE

The Member States of the European Union are facing a pensions crisis due to their ageing populations: the cost of supporting an increasing number of elderly people places a heavy burden on tomorrow's workers.

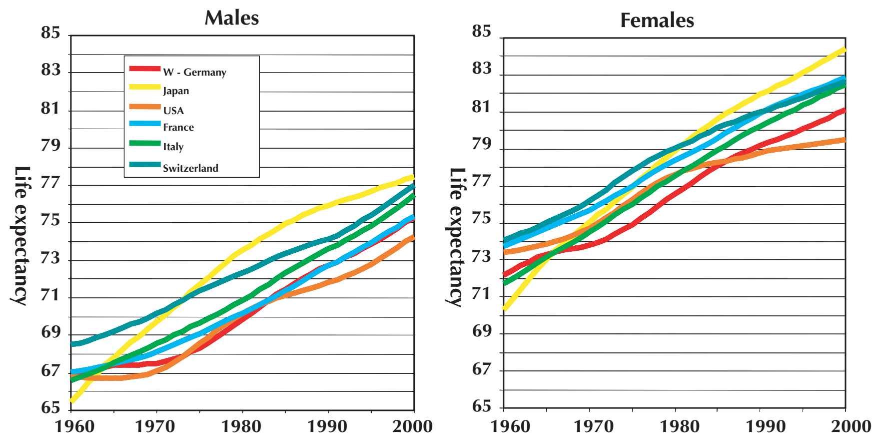
In Europe and the rest of the world, the ageing of the population is driven by two different trends: the fall in the birth rate and rising life expectancy. Between 1960 and 2003, the birth rate in the EU 25 fell from 2.6 to less than 1.5.

Figure 1: Total fertility rate, 2003, and change between 1960 and 2003*



Between 1960 and 2000, life expectancy at birth rose from about 72 to 81 for women and from about 67 to 75 for men in the EU 25 and continues to rise.

Figure 2: Life expectancy rose rapidly between 1960 and 2000 for various countries



source: GDV

Table 1 below shows that spending on state pensions is projected to increase by between 3 and 5 percentage points of GDP in most Member States in the coming decades.

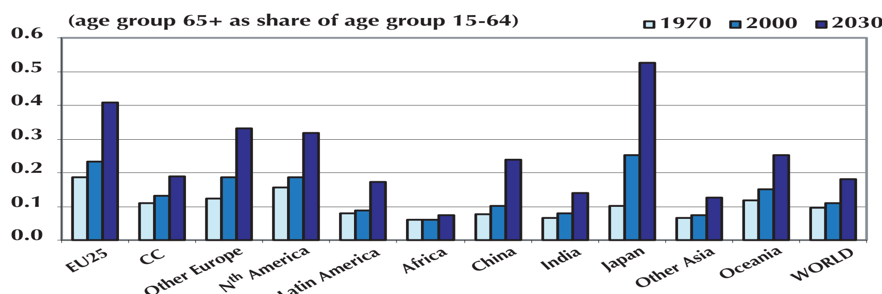
Table 1: Projections for spending on public pensions as share of GDP

Source: EPC (2001)	2000	2005	2010	2020	2030	2040	2050	Change 2000 -50
BE	10.0	9.5	9.9	11.4	13.3	13.7	13.3	3.3
DK	10.5	11.3	12.5	13.8	14.5	14.0	13.3	2.9
DE	11.8	11.4	11.2	12.6	15.5	16.6	16.9	5.0
EL	12.6	12.4	12.6	15.4	19.6	23.8	24.8	12.2
ES	9.4	8.8	8.9	9.9	12.6	16.0	17.3	7.9
FR	12.1	12.2	13.1	15.0	16.0	15.8		3.8
IE	4.6	4.5	5.0	6.7	7.6	8.3	9.0	4.4
IT	13.8	13.8	13.9	14.8	15.7	15.7	14.1	0.3
LU	7.4	7.4	7.5	8.2	9.2	9.5	9.3	1.9
NL	7.9	8.3	9.1	11.1	13.1	14.1	13.6	5.7
AT	14.5	14.5	14.9	16.0	18.1	18.3	17.0	2.5
PT	9.8	10.9	11.8	13.1	13.6	13.8	13.2	3.4
FI	11.3	10.9	11.6	12.9	14.9	16.0	15.9	4.7
SE	9.0	9.2	9.6	10.7	11.4	11.4	10.7	1.7
UK	5.5	5.3	5.1	4.9	5.2	5.0	4.4	-1.1

So far, Eurostat has not seen any reversal in these trends, either in respect of the birth rate or life expectancy. Therefore, it expects that there will be an upwards trend in the old-age dependency ratio. That is to say, the percentage of those aged 65 in relation to those of working age (20-64) will rise from about 23% to 41% between 2000 and 2030. In other words, while there are now four people of working age to support each pensioner, by 2030 there will be only a little more than two.

I. THE DEMOGRAPHIC CHALLENGE

Figure 3: Old-age dependency ratio



Source: UN World Population prospects (2002 Rev. - Medium Variant); For EU25 : Eurostat 2004 Demographic Projection (Baseline scenario); CC= BG, RO, HU, TR

Even if the birth rate started rising immediately again in the EU 25, this would only affect the age structure in the very long term. Nor can an increase of immigration stop the ageing process. According to calculations made by the United Nations, for example, a net total of approximately 190 million young people would have to migrate to Germany by 2050 to keep the old-age dependency ratio stable. This is well over double Germany's current population.

As a result of the declining ratio of contributors to beneficiaries, the Pay As You Go (PAYG)-financed state pension systems are coming under considerable pressure. The demographic instability of the PAYG system results from the fact that the contributions made each year, which are paid by the employed, are wholly used to finance the pensions of today's retired population. Given increasing life expectancy and low birth rates, today's and tomorrow's working people will have to pay the pensions of a rising number of pensioners.

The changing ratio of pensioners and contributors puts PAYG systems under pressure.

In light of this, several European countries have already modified their PAYG-financed old-age pension schemes, with a view to achieving an even balance between future contributions and benefits while ensuring the burden is shared between on both young and old. Table 2 reflects today's situation:

Table 2: Compulsory Pensions – Value (% of former income of average earner) and years of contribution in 2000 and 2050 in 6 of the EU's largest countries

	2000 Contr. Yrs	2000 Value (%)	2050 Contr. Yrs	2050 Value (%)
France	38.5	70	42 (+)	60
Germany	45	70	45	49*
Italy	35	70	40	64
Poland	37.5	61	42.5	49
Spain	35	65	35	65
UK	44	38	44	23

* 2040 - source: VDR

source: ABI, European Pension Reform and Private Pensions, 2004

The projections for 2050, however, should be treated with caution. If the past is a guide to the future, it seems likely that some governments will advocate further cuts in pension levels over the coming decades. ■

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II. COPING WITH THE CHALLENGES - THE ROLE OF FUNDED PENSIONS

Given the challenges which face pension systems all over Europe, policy-makers are faced with a limited number of options for preserving the current PAYG systems:

- Keep contributions at current levels but accept that the **value of state pensions will fall**;

- **Increase taxes or contribution levels** to maintain PAYG state pensions at their current level;

- **Increase the employment rate** in order to increase the number of people contributing to the state pension;

- **Raise the average age of retirement** in order to increase state pension contributions and reduce state pension costs.

These choices are not mutually exclusive and it is likely that national governments will choose a **combination of them**.

Most of these options involve difficult decisions for national governments. Cutting the state pension level is seldom popular. Raising taxes or contribution levels increases the cost of labour, something which is difficult to sustain within the context of increasing global competition.[1] Increasing the employment rate can only be achieved following concerted action, and changes in the age of retirement are likely to be highly controversial. However, there is also another way of dealing with the pensions crisis – **encouraging voluntary saving in funded pensions**.

National governments have already begun to embark on this strategy. They have done so for several reasons:

- By using a mixture of PAYG and funded provision, the cost of population ageing is spread more fairly between generations;

- While making people save more by means of statutory measures is nearly always unpopular, providing fiscal incentives to encourage people to undertake voluntary saving is usually welcomed;

- Funded pensions provide certainty for those who save in them, whereas state pension provision, exposed as it is to the fiscal constraints of population ageing, runs the risk of being cut back;

- Funded pension systems contribute to economic growth. By accumulating individuals' savings they provide a source of long-term investment capital for industry.

- If properly encouraged and incentivised, funded pension provision can increase the savings rate, with its concomitant benefits for the productive capacity of the economy.

The current situation in Europe is not characterised by a simple choice between a PAYG system or a funded system. In practice, all European old-age pension systems currently provide a mixture of a state-managed PAYG-financed pillar and some degree of private funded pensions. However, the state managed PAYG-financed pillar predominates in every country. Given this starting point, a complete switch to a purely funded system is not a realistic option since pension entitlements acquired in the PAYG system would have to be funded out of current contributions. The PAYG pillar also usually includes certain **redistributive elements** which could not easily be met through the tax system. Therefore, the insurance industry is not advocating a complete switch to a wholly funded system. However, a greater reliance on funded pensions could help limit the enormous burden that would otherwise fall on future workers.

> A complete switch to funded systems is neither feasible nor desirable.

1 Even today, in some European countries the problems caused by demographic factors are aggravated by the erosion of contributions due to the "black economy" and by a trend for the age of new entrants to the labour market to increase, therefore shortening the duration of working life.

II. COPING WITH THE CHALLENGES - THE ROLE OF FUNDED PENSIONS

A mixed system of PAYG and funded pensions is also desirable from a **labour market** perspective. Increasingly, PAYG contributions are often viewed as a labour tax which can discourage people from looking for jobs in the formal economy and industry from creating new employment opportunities. Paying contributions into a voluntary funded system, however, avoids creating disincentives for work.

Strengthening the funded pillars of old-age provision is also desirable from the point of view of **risk diversification**. This is because PAYG-financed and funded old-age provision schemes are exposed to different risks. While PAYG schemes are more exposed to demographic risks, funded schemes are exposed to capital market risks (though these risks can be minimised). This is why a balanced mixture of PAYG-financed and funded elements, is superior to an old-age pension system which relies on only one form of financing. In fact, the better diversified the system is , the more robust it is with regard to different kinds of shocks.[2]

> Strengthening the funded pillars increases diversification of risk in old-age provision systems.

While it is true that funded schemes are not wholly unaffected by demographic trends, funded old-age provision schemes are much more resistant to ageing than PAYG schemes (see asset melt-down hypothesis in the box).

2 *In its current report "Old-Age Income Support in the Twenty-first Century", the World Bank calls for well-balanced diversification of old-age provision systems, see: World Bank (2005): Old-Age Income Support in the Twenty-first Century: An International Perspective on Pension Systems and Reform.*

Why the asset melt-down hypothesis is unconvincing.

Funded pensions, while far more resistant to ageing than PAYG systems, are not wholly unaffected by demographic trends. For example, it is possible that investment returns may fall due to a decline in the supply of labour (assuming retirement ages do not rise). The extent of the decline in rates of return, however, will not be substantial. Several studies show that this holds true even in the hypothetical case of an economy that is excluded from international capital exchange.[3] It is also argued that asset prices may fall as the proportion of young people seeking assets to old people selling assets falls. However, the asset melt-down hypothesis ignores some essential points. First of all, in many European countries the savings ratio of retirees is at present positive. Secondly, even if the savings ratio of retirees became negative, the demand from younger people in the capital markets, which will arise in the future due to the extension of funded schemes, will be likely to make up for the reduced demand due to ageing. Demand within a given nation is also likely to be increased by investors from economies where ageing is slower. Finally, the fact that asset prices are determined not only by the number of buyers or sellers in the market, but also by expectations of earnings in commodity markets ("dividend discount model"), will also have an upward impact on price. ■

3 *See, for instance, OECD (2005): The Impact of Ageing on Demand, Factor Markets and Growth, Working Paper n° 420 (29 March 2005) or Börsch-Supan, A., A. Ludwig and M. Sommer (2003): Pension Reform, Capital Markets and the Rate of Return. MEA Discussion Papers, Mannheim mimeo.*

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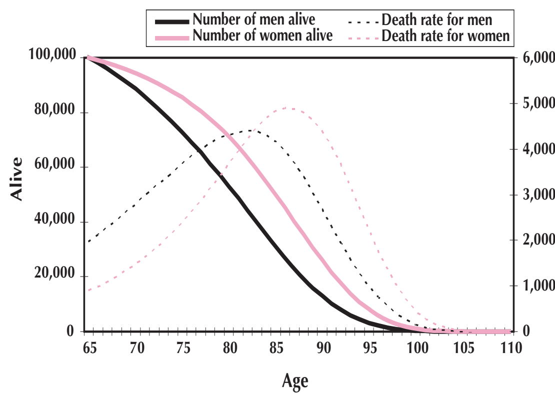
III. HOW INSURERS CAN HELP TO MEET THE DEMOGRAPHIC CHALLENGE

Life insurers play a major role in occupational pension schemes (2nd pillar) and individual pensions (3rd pillar) all over Europe. This is due, especially, to their expertise in managing the longevity risk and in asset liability management.

Longevity Risk: Annuity products guarantee a specified income until death, no matter how long an individual lives. About 50% of people live longer than average, many men may expect to live past 95, many women past 100, without then having the risk of outliving their assets. 13% of European men and 26% of European women may expect to exceed 90 years of age.

Figure 4: Weighted European mortality table



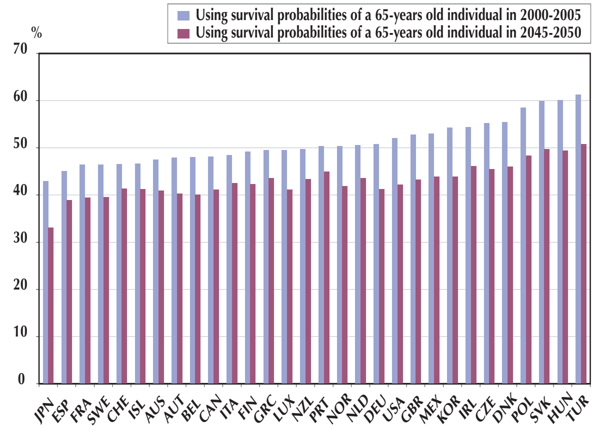
(Source: CEA compilation of national mortality tables)

Annuities offer the cheapest way to provide a guaranteed income for life. Insurers achieve this by pooling a large number of contracts, thereby balancing the risks from those who live longer than usual against those who live shorter than the norm.

If an individual wishes to be sure of having a sufficient income without buying an annuity, he or she would need to save far more than would be needed to buy an annuity. This is because an individual cannot pool or balance the risk of living longer than expected.

The welfare gains of buying an annuity are considered to be substantial. To be sure of not outliving his or her assets, the OECD estimates that an individual would need to save an additional 25%-45% more capital by the age of 65 than would be needed to buy an annuity providing the same level of income.

Figure 5: Welfare gains from buying an annuity as % - High aversion to risk



Source: annex 3 to OECD Economics Working Papers no. 420 - The impact of ageing on demand, factor markets and growth

Asset Liability Management: Life insurers, and pension funds, also have expertise in asset liability management (ALM). ALM ensures that pension contributions and investment practices are sufficient to meet a promised level of pension (Defined Benefit). This involves managing rates of return, interest rates, indexation, maturities and pay-out terms (annuities or lump sum), how long people will live (longevity) and how their health will be affected by their age (morbidity risk). Techniques used include: modern risk management, long-term investment strategies, diversified and prudent investment. The objective is to ensure higher rates of return at a reduced risk to the capital investment.

Insurers also offer products that are linked to the value of the investments (Defined Contribution) but also include a guaranteed element. This provides the opportunity for superior investment performance at reduced risk. This helps to ameliorate the risk of the fund value having fallen at the time when the fund is to be converted into a pension income ("timing risk"). As a result, the individual does not need to worry about

III. HOW INSURERS CAN HELP TO MEET THE DEMOGRAPHIC CHALLENGE

optimising the moment at which the fund is converted into a lifetime income.

Nevertheless, where required, insurers use a range of other **methods of reducing risk** such as "life-styling", where assets are gradually switched from volatile assets to more stable ones near retirement. They also offer products, such as "income drawdown", which ensure that potential growth is maximised by only converting part of the fund into an income stream. This latter approach is particularly valuable to those who can afford to take higher risks in return for higher growth.

Strong supervision and regulation garantee that insurers keep their promises.

Insurance products also pose a reduced risk to investors as they are subject to **comprehensive regulation and supervision** by public authorities. Compliance with the solvency margin and other prudential financial rules (for example, such as those set by the European life insurance and pensions directives), means lower risk and a higher level of protection for the consumer.

Insurance products are flexible and individual.

Insurers provide **flexible products** that suit today's mobile workforce. They can provide portability and transferability. They can also provide cover against the risk of death, disability and sickness or meet the costs of long-term care. Moreover, as they are market driven, insurers continually seek to adapt their products to meet the changing needs of society.

Insurance products can play a role in achieving the **social policy objectives** of national governments. The transfer of risks from the individual to a pool of insured individuals provides an inherent element of risk-sharing and "solidarity". The social policy role of insurance products can be enhanced by the design of fiscal incentives.

Private insurance products allow for the integration of socio-political aspects…

It must be stressed, however, that in cases where individuals are not compelled to buy an insurance product (voluntary saving), private insurers' activities can only be successful where they are permitted to use **insurance-specific principles** such as using information and data on risks, insurability, probability, and mutualisation. Private insurance operating in a voluntary environment cannot operate in the same way as compulsory social security systems. ■

…but necessarily rely on the principle of risk-equivalent premium calculation.

IV. HOW GOVERNMENTS CAN HELP PEOPLE SAVE FOR RETIREMENT

Almost three out of four EU citizens are concerned about their future pensions[4]. It is a legitimate concern, as the shortfall between what people currently receive from state pensions, and what they can expect to receive in 2050 if pension contribution levels are not increased, is estimated at about 456 billion euro per annum[5].

And yet, although state pension provision is expected to fall (in relation to average earnings) in the future, and despite the existence of funded pension products, **many people are not saving enough for retirement**.

We believe that this shortfall is due to people not fully understanding what they can expect to receive from state pension provision, nor how much additional pension saving is needed to ensure an adequate level of income in retirement. But there is much that national and EU decision-makers, often in partnership with the private savings industry, can do to remedy this situation.

Above all, national governments should ensure that every person has access to **easily understandable and meaningful information** about their future state pension entitlement and how much extra private saving is necessary. Several Member States have already introduced initiatives in this area. For example, in Germany, Denmark, France and Sweden, each year every adult is sent an annual statement detailing their current state pension entitlement and how much they can expect to receive if they continue to work until the normal retirement age. This information is often available on-line and in some circumstances, also includes projected income from private pensions.

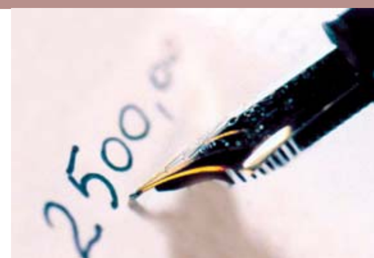
Similarly, in the UK, such "**combined pension forecasts**" will be introduced over the next few years. In the meantime, private pension providers are already required to provide an annual statement setting out the current value of the pension and how much it will be worth at the age of retirement (Statutory Money Purchase Illustrations). In the UK, the insurance industry, in collaboration with the Financial Services Authority (FSA), has also introduced a web-based pensions calculator, which can be used to estimate how much private pension saving would be needed to achieve a specified level of retirement income.

Figure 6: ABI / FSA: Pensions Calculator

The task of ensuring that people understand how much they need to save for retirement is far easier where people have a good understanding of the financial issues involved. This is why, in many countries where some reliance is placed on voluntary saving, governments aim to raise the **financial capability** of the population. Typical measures include: incorporating financial decision-making within the school curriculum, ensuring that government organisations or regulators provide information on financial products to the public; public information campaigns, for example TV advertising, to help people understand the issues involved in increasing saving or taking on debt, and providing free to use web-based financial planning tools. Sometimes, countries have set up a separate government commission specifically to take this agenda forward.

4 *Eurobarometer 62.1 – Autumn 2004*
5 *European Financial Services Roundtable, 2003 (Relates to EU15 only.)*
6 *Bridging the Savings Gap: An Evaluation of Voluntary and Compulsory Approaches to Pension Reform, PricewaterhouseCoopers, June 2005*

IV. HOW GOVERNMENTS CAN HELP PEOPLE SAVE FOR RETIREMENT



Another way in which national governments can help stimulate extra pension saving is by the use of **fiscal incentives**. Most EU countries already use some form of fiscal incentives – usually on the EET model (contributions exempt, investment income exempt, but taxation at the point of withdrawal). We suggest that national governments should maintain and, if necessary, expand such measures if they are to help people save for retirement. As clearly demonstrated in a recent comprehensive study on the impact of fiscal incentives on pension saving[6], fiscal incentives are most effective for those with low or average incomes. However, other recent experience shows that it may be necessary to ensure that recipients fully understand the value of the tax relief provided. One way of achieving this is to re-brand tax-relief as being a matching payment.

Moreover, in order to help people make the right decisions about their additional pension savings, it is also important that national governments and national decision-makers, ensure that consumers **benefit from an appropriate regulatory regime**. This should be set at a level that will ensure people fully understand the nature of the commitment they are entering into. However, it is also important that the cost of regulation is not too great as, where this is the case, it may become uneconomic for private pension providers to reach those on lower incomes where pension contributions are generally lower.

Governments can also help to encourage the savings culture by ensuring that companies can freely compete with each other and offer products tailored to the needs of customers (**fair competition**). This will usually involve ensuring that pension providers can easily establish access to national markets as there are currently few situations where cross-border arrangements are likely to be appropriate to customer needs.

There are, of course, many other ways of encouraging the savings culture. Indeed, this is a dynamic area and governments are continuously innovating and experimenting. Therefore, it is important that all the relevant government decision-makers **work together at an EU level to monitor developments and identify best practice**. ■

V. RECOMMENDATIONS TO POLICYMAKERS

Insurers play an important part in complementary pension cover. But they can play a greater role if they are assisted in this task by a policy environment that encourages saving and a savings culture. Therefore, to help foster the development of funded pensions and ensure that individuals have an adequate income in retirement, the European insurance industry urges national and EU policymakers to:

- Encourage national governments to provide accurate and easily understood information on the actual value of pension benefits each individual can expect to receive from state provision;

- Encourage national governments to develop financial education and financial capability related to retirement provision so that individuals will be able to make an informed choice about whether, and how much, to save in addition to state pension provision;

- Encourage national governments to provide effective fiscal incentives with a view to promoting long-term funded pension saving;

- Ensure that the EU and national regimes for consumer protection balance the need to protect consumers with the need to facilitate extra savings in occupational or individual pensions;

- Guarantee fair competition and a level playing-field amongst all operators in the 2nd or 3rd pillar of the pension field;

- Make use of the EU's Open Method of Co-ordination as a forum to monitor the adequacy and sustainability of pensions and share best practice examples of dealing with ageing populations and promoting funded pensions. ■

List of Acronyms

ABI	Association of British Insurers
ALM	Asset Liability Management
EET	Exempt Contribution – Exempt Investment Return – Taxed Benefits
EU	European Union
EUROSTAT	Statistical Office of the European Communities
FSA	Financial Services Authority (UK)
GDP	Gross Domestic Product
GDV	Gesamtverband der deutschen Versicherungswirtschaft (German Insurance Industry Association)
OECD	Organisation for Economic Co-operation and Development
PAYG	Pay As You Go

Pensions Terminology[7]

1st pillar (public pension plan)
Social security and similar statutory programmes administered by the general government (that is central, state, and local governments, as well as other public sector bodies such as social security institutions).

2nd pillar (occupational pension plans)
Access to such plans is linked to an employment or professional relationship between the plan member and the entity that establishes the plan (plan sponsor). Occupational plans may be established by employers or groups thereof (e.g. industry associations) and labour of professional associations, jointly or separately. The plan may be administered directly by the plan sponsor or by an independent entity (a pension fund, an insurance company or another financial institution acting as pension provider). In the latter case, the plan sponsor may still have oversight responsibilities over the operation of the plan.

3rd pillar (private pension plans)
A pension plan is administered by an institution other than general government. Private pension plans may be administered directly by a private sector employer acting as the plan sponsor, a private pension fund or a private sector provider. Private pension plans may complement or substitute for public pension plans. In some countries, these may include plans for public sector workers.

Annuity
A form of financial contract mostly sold by life insurance companies that guarantees a fixed or variable payment of income benefit (monthly, quarterly, half-yearly, or yearly) for the life of a person(s) (the annuitant) or for a specified period of time. It is different than a life insurance contract which provides income to the beneficiary after the death of the insured. An annuity may be bought through instalments or as a single lump sum. Benefits may start immediately or at a predefined time in the future or at a specific age.

Dependency ratio
Typically defined as the ratio of those of non-active age to those of active age in a given population.

EET system
A form of taxation of pension plan, whereby contributions are exempt, investment income and capital gains of the pension fund are also exempt and benefits are taxed from personal income taxation.

Funding
The act of accumulating assets in order to finance the pension plan.

Funding level
The relative value of a scheme's assets and liabilities, usually expressed as a percentage figure.

Mortality table
A chart showing rate of death at each age.

Pension funds
The pool of assets forming an independent legal entity that are bought with the contributions to a pension plan for the exclusive purpose of financing pension plan benefits. The plan/fund members have a legal or beneficial right or some other contractual claim against the assets of the pension fund. Pension funds take the form of either a special purpose entity with legal personality (such as a trust, foundation, or corporate entity) or a legally separated fund without legal personality managed by a dedicated provider (pension fund management company) or other financial institution on behalf of the plan/fund members.

Replacement rate
The ratio of an individual's (or a given population's) (average) pension in a given time period and the (average) income in a given time period.

7 *Extract from Private Pensions – OECD classification and glossary (2005)*

Photos: European Commission Audiovisual Library, COMSTOCK, CEA.

PENSIONS FOR AN AGEING SOCIETY

Choices and Solutions

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