TACKLING PENSION COSTS

Ask the industry:

With rising public costs being faced worldwide, many countries are eyeing up pensions as a place to cut expenses, whether by increasing the state pension age, cutting public pension budgets, or redirecting private pension investments. *European Pensions* asks: What lever would the industry most like to see used to help address rising pension cost concerns, and which countries are ahead of the curve in addressing this issue?

We have all experienced several examples of government actions targeting first pillar pensions as a way to reduce public costs, with an increase of the state pension age being one of the most recurrent 'tools'. This action often comes along with state pensions becoming lower and lower, especially for younger generations.

Indeed, it is a challenging task to contest this trend concretely. Having accepted that such a trend is in place, mitigating actions are possible. From my observation point (Previnet provides admin services to pension schemes across Europe), European governments should favour, more than now, a more robust and more prosperous second pillar. Citizens need to build up richer private pensions. How to do that? Several answers are possible. My favourite is auto-enrolment. The UK, somehow Italy and soon Ireland, have put in place measures to automatically enrol new workers into second pillar pension schemes. EIOPA explicitly has sent the same message to member states. In short, auto-enrolment, adequately explained to workers, is the appropriate lever to mitigate the effect of lower and lower public pensions.

MARTINO BRAICO
Previnet senior manager

Demographics is the main challenge for most state pension systems based on pay as you go (PAYG). Across the world, we have experienced falling fertility rates and increasing life expectancy resulting in ageing populations. For a pension system to be financially sustainable, it needs to be generation neutral. Some countries addressed this demographic challenge in time. One such example is Sweden which, in the mid-90s, transformed its state pension from an unsustainable DB state pension to a notional DC state pension. The notional DC state pension is a PAYG system with a buffer fund (managed by the AP funds), which is designed to be generation neutral. In addition, most employees in Sweden have a workplace pension organised through collective agreements. Countries that did not proactively address the changes in demographics in the past are now forced to increase the state pension age and/or reduce state pension benefits. This is to protect future generations of retirees, by sharing the costs more evenly across generations.

STEFAN LUNDBERG
Folksam Life strategic business development

Pension systems in many countries, especially those based on pay as you go (PAYG), are under significant pressure. Government measures have primarily focused on ensuring sustainability, but often at the expense of adequacy. While these reforms may keep future pensions sustainable, they may not provide sufficient income for retirees. Funded pensions (occupational or personal) that supplement PAYG systems will be the only credible solution. Given the looming pension crisis and the slow growth in funded pension coverage, tax incentives and 'soft' measures, like information campaigns, may no longer be enough. Auto-enrolment, though helpful, might also fall short in countries reliant on PAYG systems, where the culture of funded pensions is weak. Since building a pension pot takes years, there is little time left to prevent future poverty among millions of retirees. Therefore, governments need the political courage to mandate participation in funded pension schemes, especially for younger generations.

FRANCESCO BRIGANTI
Cross Border Benefits Alliance-Europe secretary general

Instead of focusing only on one solution, a variety of instruments should be considered when adjusting pension systems to demographic and economic changes.

Raising retirement age is a key measure in the context of increasing life expectancy, low fertility and ageing population. Many countries have already linked retirement to life expectancy which cuts spending by reducing the duration over which pensions are paid and increases revenues through longer payment of pension contributions. Raising retirement ages also prevents benefit levels from declining too low.

Another option is to create automatic adjustment mechanisms which, by means of predetermined rules, aim to stabilise the contribution and benefit levels and divide the risks more evenly between generations. These could react by cutting the index increases of pensions in payment but also by increasing the pension contribution. For example, Sweden, Germany and Canada have established these kind of automatic adjustment mechanisms.

MIKA VIDLUND
Finnish Centre for Pensions liaison manager

I don't think there is any one lever that will work, and a combination of actions will be required. In Ireland, we have raised the state pension age to 66 but there appears to be little public or political will to go any higher than that. As a result of not raising it further, social insurance contributions will increase. The introduction of auto-enrolment should also help by increasing pension savings and reducing overall reliance on the state pension. The government is also in the lucky position of running budget surpluses at the moment and has decided to invest some of this by setting up a Future Ireland Fund, which will provide funding for the impact of demographic change and an ageing population. I think it will be a combination of measures like these that will work best for most countries.

JERRY MORIARTY
Irish Association of Pension Funds CEO