TACKLING EU PENSION GAPS

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Pension saving? The best time to start was yesterday, the second-best is today

The European Commission should urge member states to introduce measures to increase participation in pension schemes. Auto-enrolment (with opt-out) addresses behavioural biases and has the potential to increase the pool of risk-bearing capital and decrease the pension gap. Pension funds can provide this capital to the Capital Markets Union, financing the green, defence and digital transitions.

The EU faces a worrying pension gap as its citizens age and fewer workers have to support increasing numbers of retirees. Most citizens rely on pillar one or government pensions, which are typically Pay-As-You-Go. Demographic changes make these unsustainable. Policy makers will need to choose between raising contributions for workers or decreasing benefits for retirees. Moreover, few citizens have additional savings in the second or third pillar. Only 23% save through an occupational retirement scheme and 19% own a personal pension product. The European Commission has found that 22.9% of women and 16.7% of men were at risk of old age poverty or social exclusion in 2022.[1] Fewer than half of EU citizens are confident that they have enough saved for retirement.[2]

The Netherlands has one of the lowest rates of old-age poverty globally. This is in large part a result of our highly developed occupational pension sector. Some 85% of Dutch workers mandatorily save for their pension through their employer. Dutch pension funds manage approximately EUR 1,400, nearly 150% of the size of Dutch GDP and almost two-thirds of all IORP assets in the EU.

We certainly have our problems. We are undergoing difficult but necessary pensions reforms to make our pension system future proof and adapt to demographic realities and a modern, more flexible labour market. People outside of this system, however, such as the self-employed, often save far too little for a comfortable pension. People are all too often unaware of an inadequate pension, until it is too late to do something about it.

Nevertheless, the Dutch pension sector may provide valuable insights for European policy makers. The first is that you must start somewhere. The road to pension adequacy is long. If you wait to act before the entire route is clear and planned, you will never reach your destination. The perfect is the enemy of the good. The sooner people start to save and invest, the better their retirement will be.

The second is to minimise behavioural biases like presentism and nudge people in the right direction. People are not interested in their pensions and would rather go to the dentist than read pension information. They value current consumption more than future benefits. Short of a general obligation for both workers and employers, one option to achieve this is to install a system that automatically enrols people while giving them an opt-out. In the UK, this has substantially increased pension saving rates. If people have to take action themselves, they tend to postpone until it is too late.

Short of such measures, policy makers can harness the power of behavioural finance in other ways. Where choices are available, it must be as easy as possible to take action and make the most suitable decision. Information should be personal, clear, and timely. When people do fail to act (which they will), pension providers need to think about suitable default options.

Third, cost and trust are key. Investing is a long-term game and even slightly higher costs significantly hurt long-term returns. To most people, one percent in annual costs may not seem like much, but it will make a world of difference in terms of pension benefits. Ordinary people have better stuff to do than actively look after their pensions and will leave it to professional money managers and pension administrators. They need to be able to trust the professionals will do the right thing and keep their interest front and centre.

> **Demographic changes mean Pay-As-You-Go government pensions become unsustainable.**

In conclusion, the twin problem of insufficient funding for European companies and inadequate pensions for systems persists. The longer we wait, the less likely we are to bridge the pension gap. The most effective policy options are often the most politically difficult. The retail investment package has failed to deliver on its ambitions. The next Commission should look at how pension funds can play a role. As with investing for later, the best time to start was yesterday. The second-best time is today.

1. *European Commission, Directorate-General for Employment, Social Affairs and Inclusion, The 2024 pension adequacy report – Current and future income adequacy in old age in the EU. Volume I, Publications Office of the European Union, 2024, https://data.europa.eu/doi/10.2767/909323*
2. *EIOPA, The EU should build on past initiatives to address growing pension gaps, Eurofi Magazine, February 2024, https://www.eiopa.europa.eu/publications/eu-should-build-past-initiatives-address-growing-pension-gaps_en#_ftn1*

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Adequacy and fiscal sustainability of national pension systems

National pension systems within the EU are diverse due to historical developments, national policy choices and the economic situation. Nevertheless, all systems are facing similar challenges linked to labour market developments and population ageing.

National pension systems have protected retired Europeans' living standards in face of global challenges. However, the risk of poverty and social exclusion for older people has continued to grow since 2019, due to rising relative income poverty. Women are generally at a higher risk of poverty than men, with differences between countries. These gaps stem from gender pay differences, shorter or interrupted careers, and more part-time work. In 2022, almost one in four women in the EU aged 75 and above was at risk of poverty or social exclusion, a significantly higher proportion than for men.

Further challenges impacting the adequacy and sustainability of national pension systems are a shrinking workforce and an increasing use of non-standard forms of employment. Self-employed, part-time or fixed-term workers often struggle with low earnings and fewer opportunities to build pension entitlements. Many Member States have already taken steps to improve the inclusiveness of national pension systems and make all work count. Yet, more remains to be done. To function effectively, reforms must be accompanied by broad public debates to ensure that citizens will accept them. Reforms should be firmly based on evidence, considering both budgetary forecasts and projections of future adequacy.

Currently, statutory pension schemes are the main source of income for most European pensioners. The 2024 Pension Adequacy Report projects that, in the decades to come, income replacement rates from statutory pensions are set to decrease in most Member States. Simultaneously, the Ageing Report demonstrates that pension spending is the biggest contributor to increases in age-related expenditure. High employment participation, as well as inclusive and robust labour markets are key factors required to maintain adequate pensions in an ageing society.

To facilitate the digitalisation and pension awareness, the Commission supports the development of the European Tracking Service for pensions. This will allow people who have been living and working in different EU countries to consult their pension rights from different countries and different pillars via one platform. Financial and pension literacy is a key pre-condition for raising awareness so people can make informed choices on their savings needs, well before reaching the retirement age. To address these challenges, there is a strong need for multi-faceted solutions that go beyond pension policies.

As called for in the Demography Toolbox, EU and national policies should help ensure that people in Europe, including older generations, can fulfil their aspirations and maintain a good quality of life. Ensuring adequate pensions requires a broad range of policies that address gender inequalities at work, the financial burden of long-term care needs and poor access to social protection. Sustained efforts to implement the Council Recommendation on access to social protection and the Council Recommendation on affordable high-quality long-term care can positively contribute to remedying these issues and improve the standard of living for older Europeans.

During the recent conference on "Challenges and opportunities of longevity in Europe", discussing the findings of the 2024 Pension Adequacy Report and the 2024 Ageing Report, participants agreed that maintaining both the adequacy and sustainability of pensions are inseparable policy objectives that should be guiding reform efforts. Furthermore, in its report, the High-level group of experts on pensions highlighted that Member States should create or retain a pension-friendly legal environment (social, labour and tax law) and an appropriate prudential framework. Respecting each country's social model, Member States should take a long-term and holistic approach to developing multi-pillar pension systems, based on strong public pensions and acknowledging the specific roles of different types of schemes. A European Saving and Investment Union, which President von der Leyen proposed in the Political Guidelines for the upcoming Commission, can help leverage the power of capital markets in the EU to boost pension saving.

Multi-pillar pension schemes can boost adequacy and fiscal sustainability of national pension systems.

Multi-pillar pension schemes can help boost the pension adequacy and fiscal sustainability of national pension systems. The EU supports Member States' efforts to ensure adequate and sustainable pensions through the European Semester, facilitating mutual learning and exchanges of best practices and reform support, notably through the Recovery and Resilience Facility and the Technical Support Instrument. Building well-designed and inclusive multi-pillar pension systems can help address the challenges discussed. The Commission stands ready to support Member States and stakeholders in this work.

PETRA HIELKEMA

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How addressing pensions gaps could help further develop Europe's capital markets

The ageing EU population and declining number of people of working age are exerting pressure on the sustainability of pay-as-you-go (PAYG) pensions. However, reforms to cut PAYG pension spending alone would increase future pensioner poverty, as statutory pensions constitute the primary source of retirement income for individuals.

Pension reforms should address the pension gaps by providing minimum social protection for all existing and future retirees and complementary retirement income sources in the form of private pensions. Privately managed pensions adapted to national circumstances can be designed to complement statutory pensions. Whether they are occupational, personal or statutory funded, these pensions all share the characteristic of being long-term investment instruments and important contributors to building Europe's internal capital market.

Recent reforms have aimed at reducing poverty (e.g. maintaining pensioners' purchasing power, increasing pension entitlements for specific groups), promoting longer working lives (e.g. limiting early retirement, increasing the pension age) and developing statutory funded schemes. Reforms to improve private pension coverage remain rare, representing a missed opportunity three-fold.

Increasing pension participation through compulsory or auto-enrolment can prove effective in reducing pension gaps. Moreover, it can contribute to the development of capital markets, which require broad coverage and scale. Well-developed capital markets can, in turn, provide new investment opportunities that benefit retirement savers and the wider EU economy.

For those reasons, addressing the pension gaps should be a priority for the next European political cycle. To achieve this, Member States should develop comprehensive and robust multi-pillar pension systems that promote secure long-term retirement savings. To ensure private pensions are accepted and trusted over time, Member States will need to foster transparent pensions systems, raise public awareness and develop simple, flexible, appealing and trustworthy private pensions.

Fostering adequate private pensions should be a priority for the new European political cycle.

Pensions dashboards can promote transparency by providing information on existing pension gaps and the adequacy and sustainability of pension systems. Additionally, they can support informed policy decision on how to allocate public funding to close the gap, whether through increased support for PAYG systems, support for auto-enrolment, or tax incentives for simple savings product in pillar 3. EIOPA has offered advice to the European Commission on both of these transparency tools and stands ready to provide additional support.

Private pensions should be flexible and portable to reflect the new labour market realities. As people change jobs, sectors, regions, and sometimes countries, and experience periods of (in)voluntary inactivity, it is essential to avoid situations where savers accrue multiple private pensions that do not contribute to ensuring pensions adequacy.

Private pensions should be simple by design, recognising that individuals often have limited understanding and may procrastinate when faced with complex decisions such as pensions. Policy makers should carefully consider the use of defaults as well as limit and frame choices to simplify pension decisions. Providing low-cost standardised solutions can cater to the needs of the majority of savers. EIOPA believes that product design needs to improve to ensure that products provide value to consumers.

Private pensions should be appealing by offering tax advantages, taking into account people's tendency to prioritise present needs. They should also be genuine in offering a real opportunity to secure a meaningful retirement income over time. However, full annuitisation may not be the best answer for all and may be disliked due to its irreversible nature and impact on inheritance intentions. Innovation seeking to extend savers' investment horizon beyond retirement age could provide opportunities to better match the pattern of people's retirement income needs and further help develop capital markets.

EIOPA has contributed to strengthening EU pensions regulation, namely IORP II and PEPP. While the PEPP is lagging behind expectations, it has many positive features that go beyond its portability: it is flexible, affordable, digital, and consumer-centric. It remains a valid option for the future, benefiting both consumers and providers. Additionally, it addresses pension gaps and demographic challenges while supporting long-term growth of the real economy and the green and digital transitions. However, for the PEPP to realize its full potential, it needs to be simplified, fine-tuned and upgraded to meet today's and tomorrow's challenges.

EIOPA's remit could be extended to assist Member States in implementing private pension reforms as well as explore the potential for an EU label or quality mark. This would foster consumer protection and sound supervision and build trust and confidence in private pensions for the future.

CHRISTOPHE GLOSER

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Enhancing pension systems and investment in the EU: a path to economic growth

The European Union is facing significant challenges in its pension systems and the distribution of long-term capital. Although there are differences across local pensions and retirement frameworks, there is a common challenge related to funding of the pension gap and to long-term wealth creation, which is set to heighten as changing demographics continue to intensify. This is why we believe there is crucial a need to encourage individuals to accumulate retirement savings and increase retail investment, and at the same time to explore solutions that can drive sustainable economic growth.

The EU currently faces a low level of pension assets relative to GDP, with a concentration of these assets in only a few member states. This imbalance poses a significant challenge to the overall sustainability of pension systems in the EU. According to data[i], the size of pools of long-term capital as a percentage of GDP varies greatly across member states. For example, countries like the Netherlands and Finland have well-designed occupational pension systems, with a significant portion of retirement income generated through this scheme. By contrast, countries like France and Germany rely more on a pay-as-you-go unfunded state pension with less developed private retirement savings.

Another key challenge is the lack of long-term capital in the EU, which hinders the development of Capital Markets Union. Transitioning from the prevalent pay-as-you-go pension system to a more funded model is necessary but would require substantial reforms that may take decades to implement with a coordinated legislative approach at European level needed to ensure ease of transfer from one country to another, which would also facilitate cross border occupational plans. The potential benefits are significant, as deep pools of pension assets and increased retail investment can have a transformative impact on the scale of long-term capital in the EU.

Investing for the long-term is highly complex, especially if you take into account the economic, geopolitical, sustainable and demographic factors. But it is a crucial one to tackle for any investors - corporate or retail. Asset managers have a key role to play to help corporate and institutional investors and their clients. Our role is even more relevant today, as we are living through increases in the cost of living across Europe, which is having a significant impact on how people approach their long-term saving plans. To address the problem effectively, a multi-faceted approach is needed. Firstly, it is crucial to encourage individuals to save for retirement by implementing pension reforms that promote funded pension systems. The Netherlands and Denmark serve as excellent examples of a countries with a well-designed occupational pension system as nearly 90% of workers are covered by occupational pension schemes.

Transitioning towards funded pension systems, could unlock substantial amounts of long-term capital.

Drawing from the success of these models, other member states could consider implementing similar reforms tailored to their specific contexts. This would involve promoting the establishment and growth of well-regulated occupational pension systems that supplement state and private pensions. It is imperative to educate and build trust and confidence in these systems through transparent fund management, appropriate contribution rates, and well-designed retirement solutions.

Additionally, retail investment needs to be widened to provide a middle ground between short-term savings and long-term investments. Lower fees, simplicity and easier market access can help attract more retail investors. Best practices from the Nordics, which have a partly funded state pension that supplements mandatory or quasi-mandatory occupational pensions, can be studied and replicated in other EU member states.

Furthermore, policymakers should consider offering tax incentives for investing in European products like ELTIFs to encourage retail investment. Reinventing savings and investment accounts for children can also contribute to building a culture of saving and investment from an early age. An EU-wide public information campaign can play a vital role in raising awareness and promoting better saving habits.

Inconclusion, the EU must address the challenges in its pension systems and the distribution of long-term capital to ensure sustainable economic growth across all member states. By transitioning towards funded pension systems, encouraging retirement savings, and promoting retail investment, the EU could unlock substantial amounts of long-term capital. This would not only benefit individuals by providing better financial futures but also support the development of capital markets, drive innovation, and foster economic growth. It is imperative for policymakers and market participants to collaborate and implement the proposed solutions, drawing from best practices of high standards of governance and robust investment processes, to pave the way for a prosperous future in the EU.

1. *Analysis of data from EIOPA, Eurostat, FSB, OECD and IMF.*

AGUSTIN REYNA
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How to bridge Europe's widening pensions gap

There is a growing pension gaps in most EU countries, meaning a discrepancy between what people will receive in retirement and what they need to maintain a comfortable standard of living.

This largely results from EU Member States reducing their engagement with pillar one pensions, expecting pillars two and three to compensate. This shift was driven partly by demographic changes that rendered the prevalent pay-as-you-go schemes in pillar one less viable. Additionally, the shift of income from labour to capital in our economies undermined pension systems funded through labour income.

Shifting the burden to consumers

The idea then was simple: shift a part of the pensions coverage into the capital markets. However, it's crucial to recognise that about 50% of the European population lacks the financial means to invest for retirement.

Consequently, a significant portion of the social dimension of this issue cannot be resolved through market mechanisms alone. For those who cannot invest, employment pensions will be the only remaining solution, shifting some income back into the labour force through pensions systems. How much this needs to be would depend on how many, and how effectively, people can afford to invest in the third pillar pension plans. So, let's look at pillar three pensions first:

What we see in outcomes for retail investments, including personal pensions, in the EU is grim:

- Poor-quality products lead to suboptimal outcomes, with many burning income potential in real terms over their runtime due to negative returns after inflation.
- These inferior products reduce the ability of individuals to save significantly because the amount of savings needed at the end of a career remains the same. The worse a product performs, the more a person needs to save to meet that threshold. And this means that fewer people have the income to do it.
- Bad products erode trust, a key factor in encouraging participation.
- This general mistrust, fuelled by mis-selling scandals and poor performance, fosters a culture hostile to investment.

A European solution?

The EU's Retail Investment Strategy (RIS) process has thoroughly examined the causes of these failures. Consumers need sound advice for investment decisions but often receive sales pitches instead. Advisors, driven by commissions, prioritise selling products that offer higher percentages rather than those beneficial to consumers.

> **Addressing the pension gap in the EU requires a focus on creating high-quality pillar two products.**

This misalignment between supply and demand results in products designed to attract distributors, not to serve consumers' best interests. Without addressing this issue, the third pillar is effectively unviable at least for the vast majority of retail investors who must rely on advice.

Since reforming pillar one pensions falls outside the EU's remit and the underlying problems remain unsolved, we must look for other workable solutions. Pillar three products require functional investment markets, but the recent RIS experience has shown a lack of political will to organise such markets in a way that benefits consumers. Thus, the logical conclusion is to focus on a pillar two solution.

Strengthening pillar two

When considering the features of a pillar two solution, we must remember: It is not possible to subsidise an inefficient product into viability. While discussing tax benefits is important, it should follow the establishment of a framework that ensures viable solutions. Injecting public money into the system during product design would reduce the pressure to be competitive, worsening the underlying product and harming both consumers and state finances.

A viable pillar two solution should therefore meet the following criteria:

- It must be cost-efficient.
- It needs a distribution vector independent of the sales interests of the incumbent industry, despite cost restrictions to avoid the fate of the Pan-European Pension Product (PEPP).
- It should offer at least one variant unrestricted by guarantees or other insurance features, allowing for an effective investment strategy.

So, addressing the pension gap in the EU requires a focus on creating high-quality, accessible pillar two products that can provide meaningful investment opportunities for the population, supported by a robust and independent distribution framework. Examples of how this could be done may be found in the UK, but other approaches are possible.

In the interest of citizens and our economy, I do hope that we can manage this. If we fail to establish a functional solution because it may inconvenience entrenched interests, it will not cement the status quo. The pensions crisis, much like the climate one is not going away. If we cannot establish a plausible solution in the EU, consumers will increasingly turn to products from the other jurisdictions like the US to satisfy their needs. The answer to this question may well decide a big part of the question if the EU is capable of being competitive in financial markets. Right now, it is not.