

Governance and coverage of supplementary pensions

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GOSPE-Project (funded by DFG, German Research Foundation)

Results to be published in Bernhard Ebbinghaus (Ed.):
Varieties of Pension Governance: The Privatization of Pensions in Europe
Oxford: Oxford University Press, in preparation, 2010

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1. „Privatization“ of Pensions facing the Crisis



Global paradigm shift:

„Reforming pensions is one of the biggest challenges of the 21st century!“ (OECD)

First **public** pillar:

- Pay-as-you-go financing, mandatory
- First tier anti-poverty policy (universal/means-test)
- Second tier earnings-related pensions (?)

Second **occupational** pillar:

- Voluntary employer-led / negotiated / mandatory
- Book reserves / funded

Third private **personal** pillar:

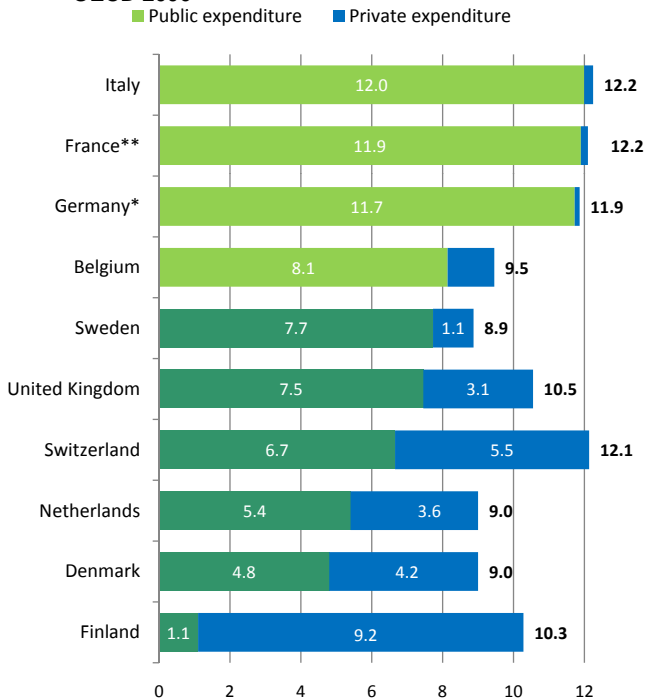
- Voluntary individual savings schemes

→ **Privatization** of social responsibility

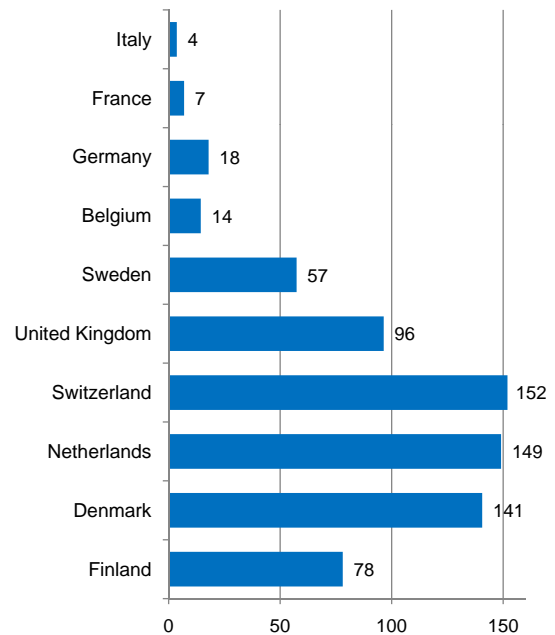
→ **Financial risks shifted** to individuals

2. Public vs Private Pensions and Pension Funds (%GDP)

Public and private pension expenditure (% GDP), OECD 2006



Total private pension assets (% GDP), OECD 2007

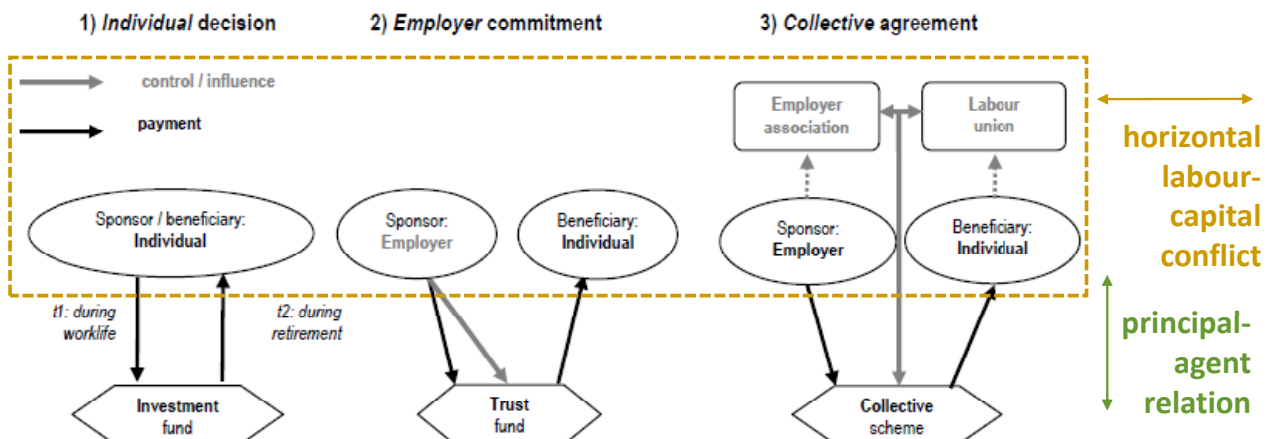


Source: OECD Pensions Outlook 2008, own calculations.

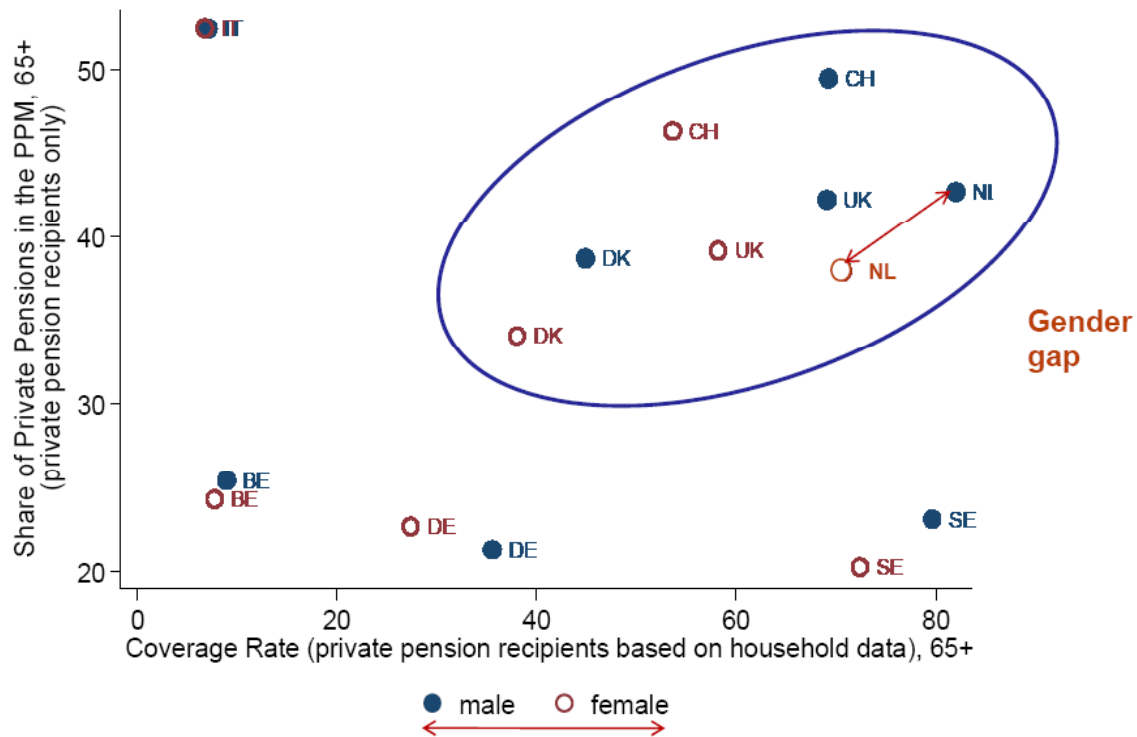
3. The Stakeholders in Private Pension Governance

Conflicts of interests in supplementary pensions:

- **Vertical conflicts** = principal-agent problem (sponsor/financial agent)
- **Horizontal conflicts:** sponsor (employer) vs. beneficiary (worker)
 - employer commitment: employer sponsors trust, implicit contract
 - collective agreement: delegated to employer/union negotiations

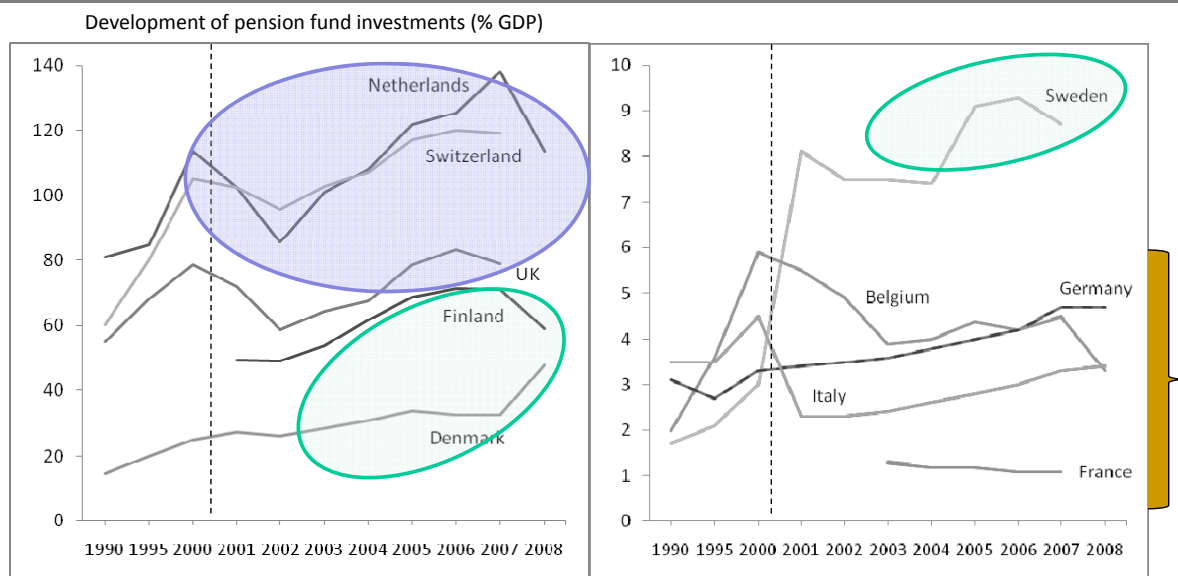


4. Coverage and Private Pension Share (Aged 65+) SHARE 2006



SHARE, Wave 2, 2006, calculated by J. Neugschwender, GOSPE Project, MZES Mannheim

5. Pension Fund Capitalism (Investments in % GDP)



- **Mature funded pension systems:** NL, CH, UK
- **Catching-up pension fund countries:** FIN, DK, S
- **Late-comers with Bismarckian tradition:** D, B, I, F

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6. Funded Pension Schemes (and Book Reserves)

EFRP data 2007	Total	% Total				
	billion Euro	Public funds	Private schemes	Private funds	Group insurance	Book reserve
United Kingdom	1,624.0	-	100.0	91.7	8.3	-
Netherlands	853.0	-	100.0	89.4	10.6	-
Switzerland	566.2	-	100.0	64.7	35.3	-
Germany	428.7	-	100.0	32.5	11.3	56.2
Denmark	244.5	24.3	75.7	25.0	50.7	-
Sweden	195.0	15.4	84.6	6.6	70.3	7.7
France	154.0	-	100.0	-	-	-
Finland	142.8	85.7	14.3	4.1	10.2	-
Italy	57.8	-	100.0	83.9	10.0	6.1
Belgium	50.9	-	100.0	29.3	70.7	-

Source: EFRP Annual Report 2008: 48-49, own calculations

7. Multiple Dimensions of Supplementary Pension Regulation

	High regulation (lower risks)	Low regulation (higher risks)
Financing	PAYG ————— (book reserves) —————	funded
Governance	collective ————— employer-led —————	individual
Coverage	mandatory ————— quasi-mandatory —————	voluntary
Benefits	DB ←—————→	DC
Indexation	legal requirements ————— self-regulation —————	no rules
Vesting	immediately ←—————→	longer period
Supervision	compulsory public ←—————→	voluntary private
Insolvency	protection funds ————— external insurances/funds —————	Book reserves/ in-house funds
Investment restrictions	high ←—————→ medium ←—————→	low

8. Governance Forms: Pro & Cons

Collective (= employer/unions agree on collective jointly managed (inter)firm scheme):

- ✓ Pooling of risks, broader coverage, lower administrative costs
- ✓ Balancing interests between sponsors & beneficiaries
- But less personal choice
- ➔ Collectively administered funds are more like public pensions

Employer-led (= employer sponsored pension fund or on the book reserves):

- Limited representation of beneficiary interests, administrative costs may be higher
- Risk of bankruptcy of firm (reinsurance needed), liability for DB underfunding
- ✓ Employer interest in binding employees (HRM strategy) but lower mobility
- ➔ Employer administered funds might cause conflicts of interests

Individual:

- ✓ Individual decision to save for old age and freedom of choice
- Depends on financial literacy, foresight and liquidity
- ➔ Individual responsibility and individualization of risks

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9. Cross-National Variations of Supplementary Pensions

Private pension assets	(Quasi-)Mandatory		Voluntary	
	High contributions	Medium contributions	Medium contributions	Low contributions
High / mature	Switzerland, Netherlands UK (opt-out OP/PP)			
Medium / catching up	Denmark (OP/PP), Finland (OP)	Sweden (OP, PP)		Finland (PP)
Late-comer	France (OP)		France (PP), Italy (OP/PP)	Germany (OP/PP), Belgium

Mature

- (Quasi-)Mandatory
- High coverage
- High contributions
- Crucial role of financial market for old-age income

Catching-up

- (Quasi-)Mandatory
- High to medium contributions
- Mainly insurance contracts

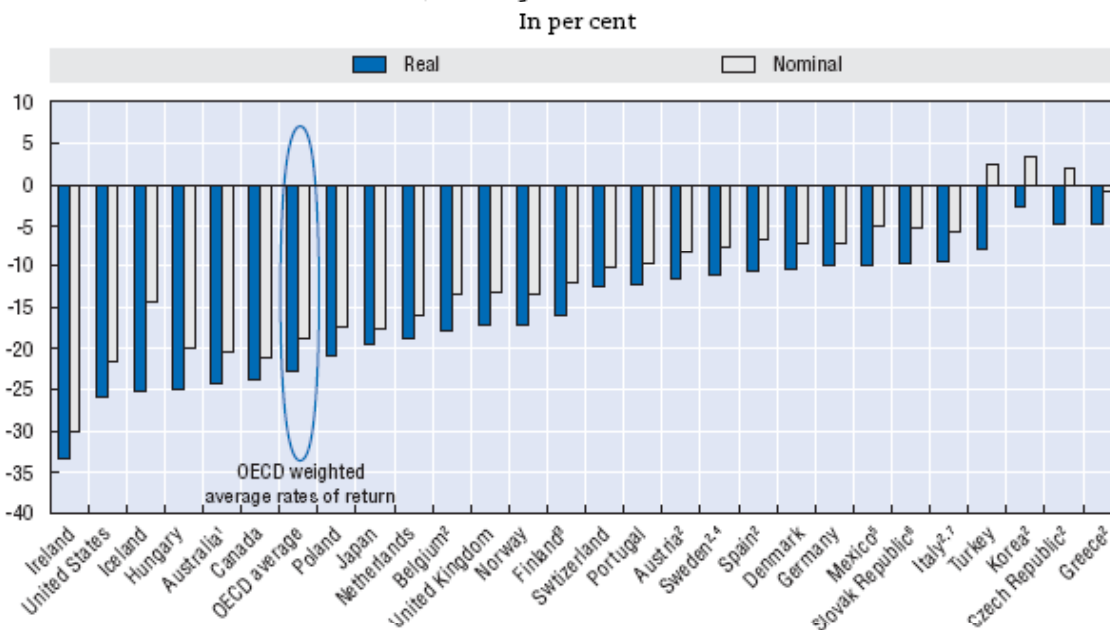
Late-comers

- Voluntary (OP, PP)
- Medium to low contributions
- Mainly internal OP but growing external modes

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Outlook: Financial crisis

Figure S.2. **Nominal and real pension fund returns in selected OECD countries**
January-October 2008



Quelle: OECD Pensions Outlook 2008

10. Conclusion: Privatization?

Privatization \neq privatization:

- Cross-national diversity in **governance** of supplementary pensions
- Privatization can lead to more state / collective **regulation**
- Collective bargaining, “opt-out”, tax subsidies increase **coverage**
- Shift of **financial risks** to employees (shift from DB to DC)
- Funded pensions:
 - > **financial market risks?**
 - > **old-age income inequality?**
- **Governance** of private pensions is gaining in importance!

