KU LEUVEN

**Die Bedeutung der Versicherungswirtschaft in Europa und weltweit**
**Herausforderungen durch die alternde Gesellschaft**

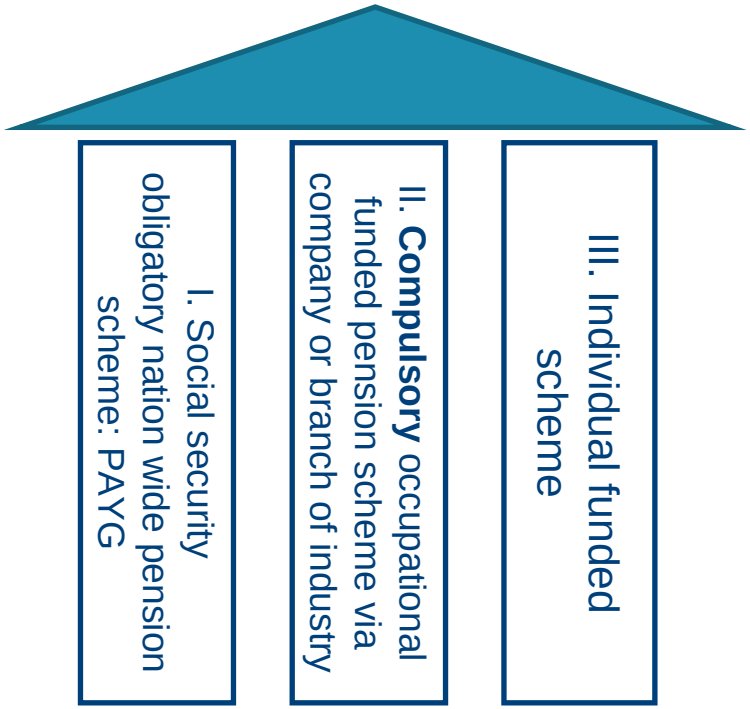
# The pension pillar implosion!?

Prof. dr. Yves Stevens

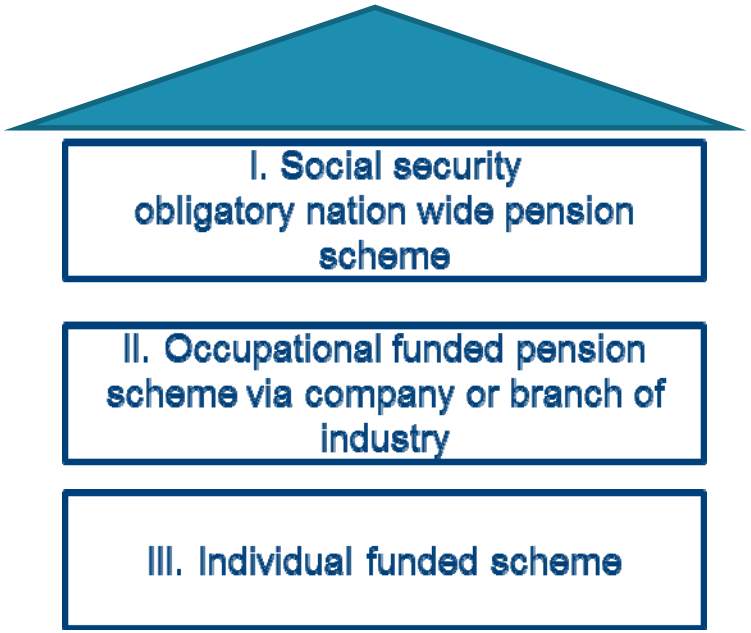
Donnerstag, 10. März 2016

# Pensions are often thought about in pillars or layers. Classically there were two models

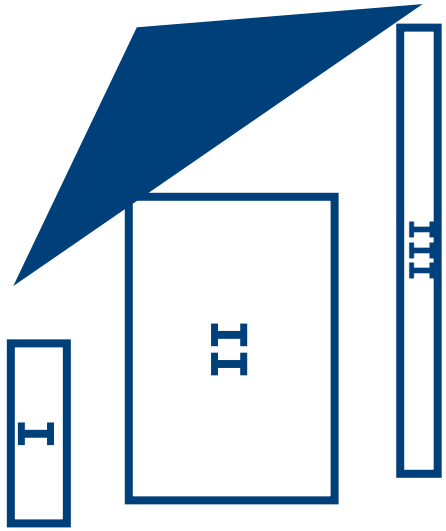
## World Bank

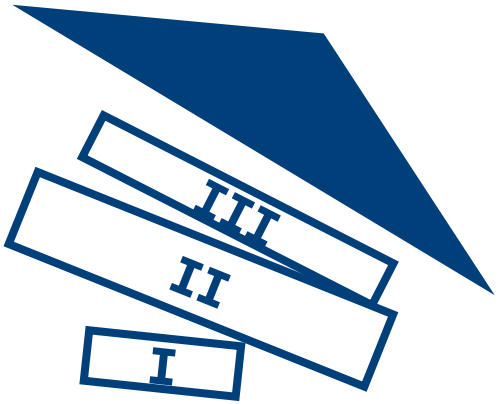



## International Social Security Agency



# Both models have been widely criticized



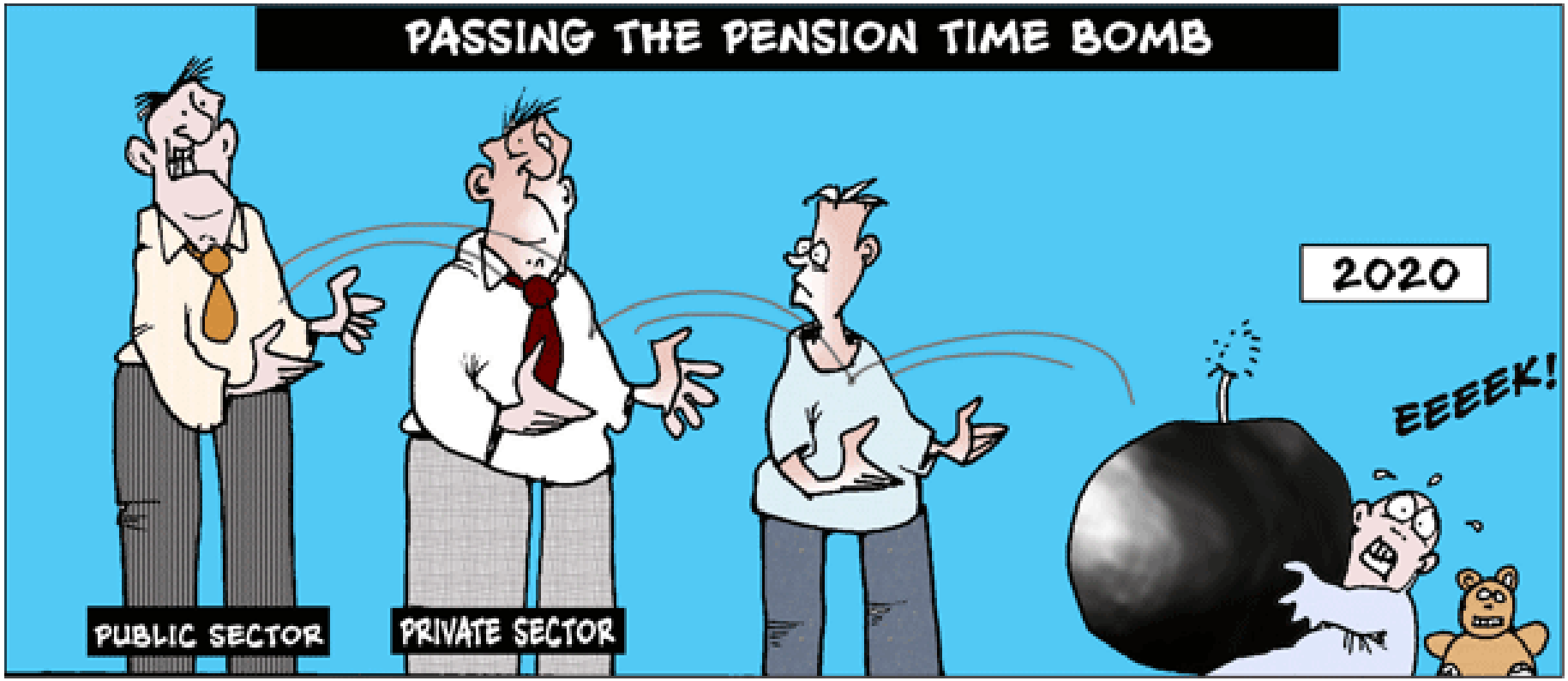




⇒ Increased income inequality – Matthew effect

⇒ Breaches of social contracts between the elder and the young (Musgrave disequilibrium)

⇒ Higher than expected economic interdependency of the “pillars” or “layers” leading to NTA studies …

⇒ …


PASSING THE PENSION TIME BOMB
PUBLIC SECTOR
PRIVATE SECTOR
2020
EEEEK!

# Lawyers look at different realities: no pillars but VERY different legal pension frameworks

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| affiliation | voluntary | | obligatory | | | mixed | | | |
| level | national | industry-wide | company | individual | | | | | |
| actors | funds | | insurers | | banks | | | | |
| booking | internal | | external | | mixed | | | | |
| coverage | overall | categories | | individual | | | | | |
| fiscal | EEE | ETT | ETE | EET | TET | TEE | ETE | TTE | TTT |
| control | prudent man → strict state supervision | | | | | | | | |
| participation | organizing | supervising | managing | none | | | | | |
| risk/cost | individual → employer → society | | | | | | | | |
| finance | repartition | open – closed capitalization | mixed | | | | | | |
| government | organizing | regulating | managing | controlling | | | | | |

No pillars but a quilt!!!

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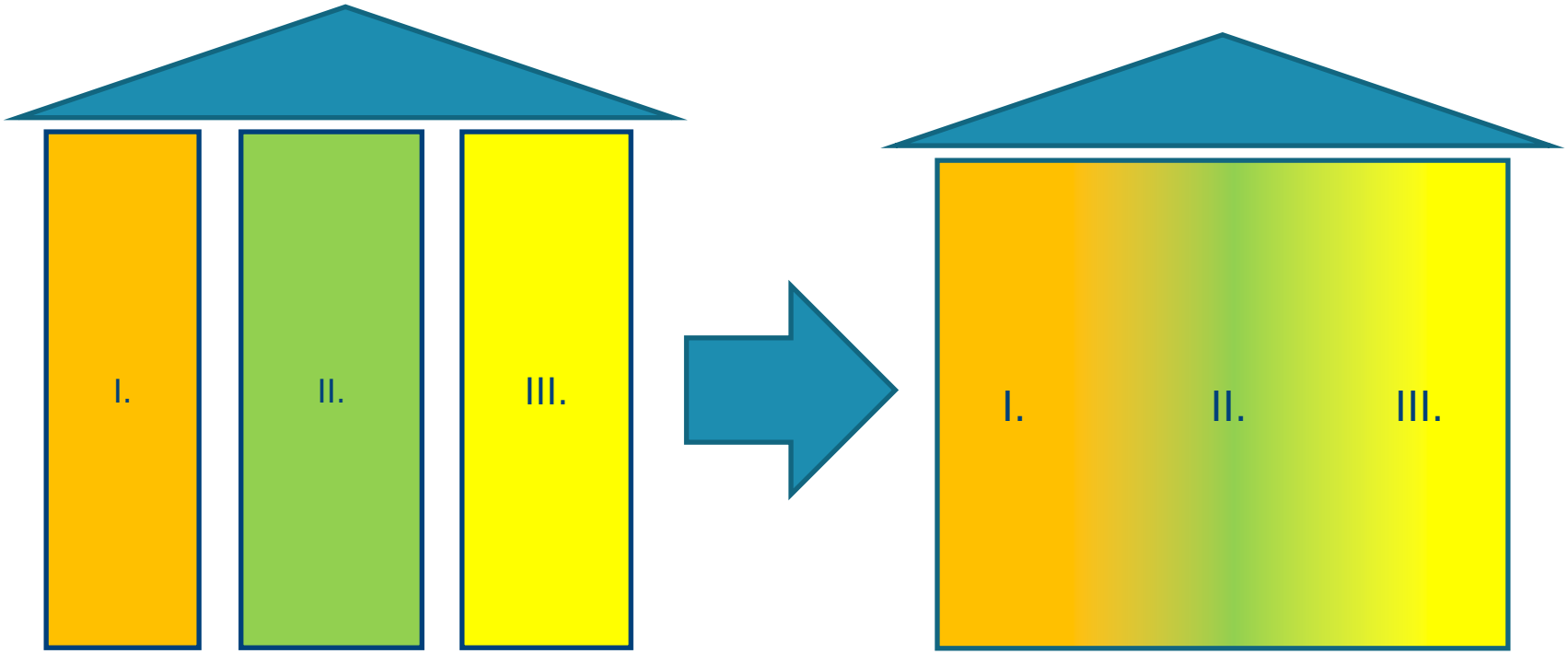
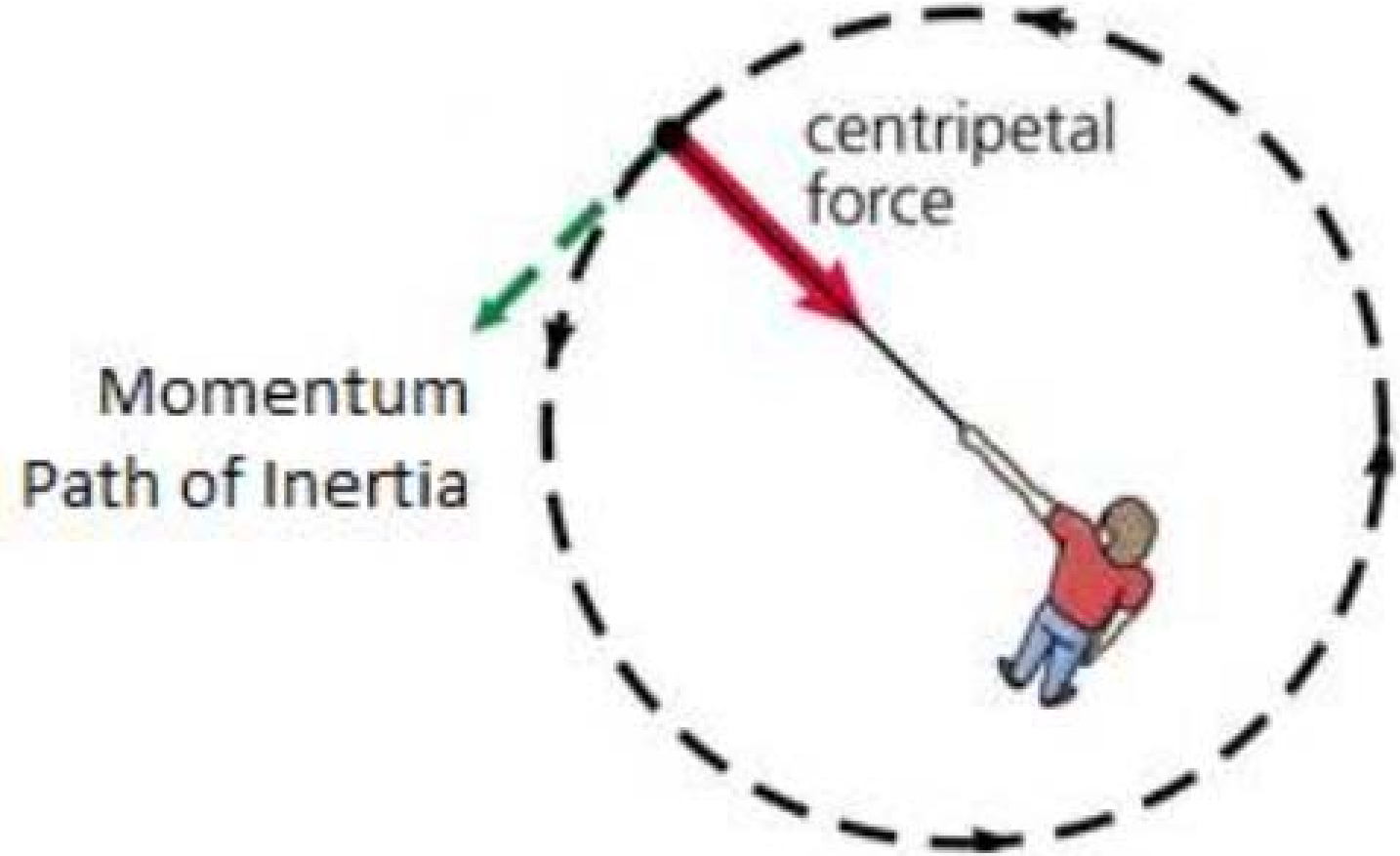
# My thesis: there is an “implosion of the pillars” or an “integration of the quilt” due to some centripetal forces




centripetal
force
Momentum
Path of Inertia

# Centrifugal forces drive governments all around the world to enhance or enforce the same principles irrespective of the "pillar"

- Financing
  - There are more and more governments bonds in second and third pillar: this is actually a form of "indirect" unfunded PAYG scheme within funded schemes
    - Linked to regulatory issues
    - Solvency issues
  - Today's low interest rate environment is not only driven by macro-economic factors but also by policy actions that help governments deal with the high sovereign debt burden – increasing the pension age for all types of pension schemes thus helps to lower the sovereign debt burden
  - Some countries (especially Eastern European) look at (or have already installed (e.g. Poland)) a pension reform whereby the government takes over the occupational pension on an individual level some years prior to individual retirement. This is not only a form of nationalisation but also a form of collective risk spreading

## Centrifugal forces drive governments all around the world to enhance or enforce the same principles irrespective of the "pillar"

- Pension communication: increasingly governments recognise the need for
  - Integrated pension communication to the individuals: this is irrespective of the "pillar" or kind of pension type for the individual
  - Embedded pension communication through (social) media that is irrespective of the financial provider: bank, insurer, fund, …

- Cross border pension rights (EU only)
  - Under the European social security regulation portability for funded schemes has been recognised
  - Tracking systems such as TTYPE is irrespective of national legal barriers

# Centrifugal forces drive governments all around the world to enhance or enforce the <u>same principles</u> irrespective of the "pillar"

- "Pension education": people don't care about the type of "pillar"
  - Financial illiteracy is an issue in all pillars. Globally, individuals fail to save enough for their retirement. Based on ample scientific proof of behavioral science, there are two principal reasons for this:
    - Humans are by nature not built to defer spending today to save more for tomorrow.
    - In the field of financial literacy much has already been tried but without success. Conventional financial education has little effect:
      - Even those who obtain good financial advice are inclined not to follow it.
      - Even people who invest into sound financial products diminish their effectiveness by eg poor timing of "buy" and "sell" decisions
      - The wealthy respond to tax subsidies for retirement but tend reallocate funds from other savings products rather than increasing the overall level of savings, rendering the subsidies ineffective (Matthew effect).
  - The focus needs to shift from financial literacy programs to a more rounded approach with an increase in the use of defaults to improve diversification and triggers such as automatic increments to boost savings' rates seems to help. This is exactly the opposite of "pension education" but shifts the savings responsibility from the individual to the collective level.

# Centrifugal forces drive governments all around the world to enhance or enforce the same principles irrespective of the "pillar"

- Cost and free structure
  - More and more governments are looking at the different cost structure of the pillars and implying the need for less miss-selling especially in the third pillar
  - The administrative costs are increasingly compared
  - More rules regarding compliance with cost transparency requirement (Suisse, Hong Kong,…)

- Accounting standards
  - Play an incredibly important role both for governments, employers and pension providers. Very well known issues in the occupational pensions with IFRS 4 or IAS 19 and the reporting issues with the accounting model
  - More and more governments are willing to measure the cost of their first pillar on a "kind" of an accounting basis

- Different tax regimes of the different pension forms are increasingly compared whereby the plusses and minuses of the pension forms are looked at for interdependency

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# THANK YOU FOR YOUR KIND ATTENTION

yves.stevens@law.kuleuven.be