BUSINESSEUROPE

SPEAKING NOTES

19 November 2013

EUROPEAN PENSION FUNDS CONGRESS, 19 NOVEMBER

WORKPLACE PENSIONS FINANCING THE FUTURE

1. The role of employers in providing occupational pensions

- Employers are committed to providing adequate occupational pensions for previous, current and future employees. This engagement of employers is highly socially desirable and should be considered as part of an employee's compensation and benefits package.
- Schemes are often covered by collective bargaining agreements and social partners are often involved in the governance of schemes, including determining in some cases the funding and benefits rights for plan members. Occupational pensions are therefore deeply rooted in national social and labour law.
- Such pensions must remain cost-effective for employers. This is already increasingly challenging for defined benefit schemes – funded or PAYG - in view of demographic change. Substantial changes to the rules governing funded pension schemes, which would raise the costs of operating them, and ultimately lead to closures, should be avoided.
- Defined Benefit schemes – at the core is the sponsor support or employer covenant. The pension fund itself covers the investment risk and the benefits are guaranteed by the sponsoring employer. This is an element which mitigates risk. But it is very difficult to measure this, at least in a quantitative way.
- We see a growing trend away from Defined Benefit (DB) towards Defined Contribution (DC) schemes. In the UK, for example, the proportion of accruing plan members in a DC scheme in 2010 was 75% and in Ireland and Sweden, 50% and 70% respectively[1]. With DC schemes, the risk is borne by the individual plan member and the pension benefits are dependent on the performance of the investments in the fund. This means that helping employees to understand the scheme and their investment choices, as well as general financial awareness are important.
- Cost is clearly an important factor in the employer's choice of scheme, as well as the governance required to ensure adequacy and sustainability. DC schemes are often presented as a low maintenance option, whereas many companies operating such schemes are fully aware that running them effectively requires engaged management and communication with employees.
- The ability of occupational pension schemes to provide an adequate pension is dependent on the extent to which they are able to make a return on their investment. Investment returns are built on investment choices. Investment choices are built on the design of pension schemes which is specific to each individual company or sector. We therefore believe that the design of pension schemes should be managed at company or sector level and want to avoid EU level regulation that lays down strict obligations.

[1] EFRP DC Pensions survey March 2010

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2. The role of occupational pensions in the economy

- Pension funds are an important source of capital for long term investors such as venture capital and private equity. They therefore play a key role in the financial markets and help finance growth, innovation and stimulate job creation.
- It is important that pension funds can continue to play this role. In particular we want to avoid rules which would lead schemes to change their investment patterns, moving away from investment in equity.
- This would restrict capital flows to businesses, at a time when the availability of finance is still a problem. In the last two years bank lending to businesses fell by € 300 billion in the Euro Area.
- This has a negative effect on the economy as a whole, as it holds back business investment which is necessary to drive growth and maintain competitiveness.

3. The role of occupational pensions in dealing with the challenges of pension adequacy and security

- In several countries private and occupational pensions provide an important part of retirement income and as state spending comes under increasing pressure, the 2nd and 3rd pillars will become more important in alleviating some of the burden of demographic change.
- Sustainability and adequacy lies in a multi-pillar pension system, with retirement income being provided through PAYG schemes but also a part of it by funded schemes.
- The balance of different pillars within the pension system is a decision for individual member states and social partners, however the diversification of sources of retirement income should be promoted as an important element in ensuring sustainability of the pension system.
- This can help alleviate some of the burden on the state pension and positively enhances shared responsibility for retirement provision and the risks involved between government, employers and individual citizens/employees.
- During this economic crisis, there have been discussions about the resilience of funded pension schemes and their ability to provide adequate pensions.
- This is a serious issue and employers are committed to providing adequate and sustainable pensions for their employees.
- However, we need to avoid a false dichotomy between risks apparent in funded systems and those apparent in PAYG systems. Risks are inherent in all pillars of the pension system. The economic crisis has only served as a reminder of this.
- Funded schemes have been hit by the falling market value of their investments. In the short-term this may require some moderate adjustments of pension levels. However, the fact that investment risks are generally taken into account in such schemes means that they are generally protected from downturns in the market. The expectation is that the financial markets and therefore the value of the investments will recover.
- The crisis has raised a broader issue of the need to look at the design of funded schemes, to ensure that they are able to cope in general with investment risk. This includes the issue of protection against longevity risk, i.e. with increasing life

expectancy will a pension fund be required to pay out more than was anticipated when the person entered the plan.

- At the same time, the drawn out problems on labour markets, in particular the continuing high levels of unemployment are detrimental for the long-term financial sustainability of PAYG schemes.
- Measures have been taken in many member states to deal with the long-term sustainability of state pensions.
- However, measures have also been taken by member states to deal with risks inherent in funded schemes, e.g. shifting to a less risky type of investment when a plan member is approaching retirement; diverting a proportion of contributions from statutory PAYG schemes to new mandatory funded schemes; allowing schemes longer periods to adapt; and governments acting as guarantors to pension funds.