Pensions in the EU: challenges, EU competencies and on-going reforms

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1. Existing pension systems in the EU

1.1. Structure of the EU pension systems

All pension systems in Europe include a public and a private part. They are usually organised in three pillars, although the functioning of these pillars differs across the EU. The terminology used to describe them also differs across Member States.

The first pillar (pillar I) consists of public statutory pensions, which are mandatory and aim to provide a basic level of income to all pensioners, including those who do not have a capacity to save for their retirement. The second pillar (pillar II) covers occupational pensions, which are sponsored by employers at an individual company, sector or industry-wide level and can be either mandatory, quasi-mandatory (with opt-out options) or voluntary. The third pillar (pillar III) are voluntary personal pensions that can be supported by tax incentives.

Public pension systems in the EU (pillar I) are generally financed on a pay-as-you-go (PAYG) basis, with the contributions to the pension system from the working age individuals paying for the benefits of current retirees, which means they are not pre-funded and have no disposable assets to invest[1]. Some pillar I PAYG schemes are however backed by a limited pre-funded reserve fund that may be used to alleviate demographic challenges. Some of them are also completed by smaller pre-funded mandatory components (as in Sweden) aiming to provide future pensioners with higher long term returns via equity and bond investments. Different mechanisms are used for determining pension benefits. Depending on the Member States, pillar I systems are based either on a defined-benefit (DB) scheme, a notional defined contribution (NDC) system or a points system or on a combination[2].

Pillar II systems are usually pre-funded and based on the principle of asset accumulation. They work on a DB or DC basis, or a hybrid of DB and DC, although a trend towards DC is generally observed, as in the Netherlands, where a pension reform was recently passed. The payment of pillar II pension benefits is usually triggered by the payment of pillar I retirement benefits. Pillar III systems work on a DC and individual basis in most cases.

1.2. Size of pension spendings and assets

The majority of pension spendings in Europe are channelled into public PAYG pensions. Eurostat statistics[3] show that the annual spending on mandatory old-age and survivor pensions (pillar I pensions and some mandatory pillar II schemes) amounted to 12.5% of GDP in the EU in 2020 on average, corresponding to approximately €1.7 Tio[4]. These expenditures however vary significantly across the EU, ranging from 17% of GDP in Greece and 16.5% in Italy to 4% in Ireland[5].

In addition to this, the annual expenditures on mandatory and voluntary private pensions represented less than 1% of GDP in most EU countries in 2019, except for the NL (5.3%), Sweden (2.9%) and Denmark (2.4%)[6].

1. Pre-funding refers to the practice of setting aside funds in advance to cover future pension obligations. Pre-funded schemes can also be described as asset-backed as opposed to PAYG schemes that do not hold assets except for a possible reserve fund. Pre-funding is typically done by employers or governments to ensure that there are enough funds available to pay pensions to retired employees or citizens. Pre-funding can also be performed by financial institutions managing supplementary pensions.
2. DB schemes provide a set level of pension at retirement depending on the length of service and the earnings over a number of years preceding retirement. With NDC schemes, the amount contributed by each individual to the system is added to a pot which is appreciated by a notional interest rate set by the government. At the end of the contribution period workers receive annuity based on the final financial value of their lifetime contributions, their life expectancy and expected return during the remainder of their lifetime in a similar way they would in defined contribution scheme. In a points system, contributions paid throughout a person's career are converted into points and the pension benefit depends on the number of points accumulated and the value of the point at the time of retirement. In a DB system the risk is in effect borne by the sponsor of the pension system, whereas in defined contribution (DC) and point systems the risk is borne by the pension holder
3. Source Eurostat Social protection statistics - pension expenditure and pension beneficiaries.
4. The total annual spending on pensions estimated by Eurostat amounts to 13.6% of GDP and €1.8 Tio, but includes disability pensions and some unemployment pensions, which have been taken out from this evaluation.
5. Other statistics from the OECD show that the annual public expenditures on old age and survivor benefits (pillar I mainly) ranged from 15.9% of GDP in Italy to 3.3% in Ireland in 2019. Source OECD Pensions at a glance 2023.
6. In these countries expenditures on public pensions amounted to 5% (NL), 7% (Sweden) and 8.1% (Denmark) in 2019 according to OECD statistics.

In comparison, in the US, Canada and UK, the proportion of private pensions is much higher. In the US, Canada and UK, annual spendings on private pensions amounted to approximately 5.6% of GDP. Spendings in these countries on public pensions are also lower than the EU average (5% of GDP in the UK and Canada, 7% of GDP in the US)[7].

As a result, the size of private pension assets in % of GDP, which comprise pillar II and III private pension assets and the reserve funds of public pillar I systems, is relatively limited in the EU on average, amounting to 29% of GDP in 2022[8], compared to 138% in the US, 153% in Canada, 131% in Australia and 85% in the UK.

The US also represents 68% of the total of assets earmarked for retirement at the global level ($35 Tio of a total of 51.3 Tio at global level), with 70% of US assets held in employer-sponsored plans such as 401(k) and 30% in individual IRAs[9], whereas the proportion of pension assets represented by the EU is below 9% ($4.6 Tio), which is below the EU share of global GDP (16%). In addition, 62% of EU pension assets are concentrated in 3 Members States (NL, Sweden and Denmark), which only account for 12% of EU GDP.

Pension assets are however growing in the EU. According to a New Financial report[10] based on OECD data, EU pillar II and III pre-funded pension assets have grown over the last 10 years from 23% to 29% of GDP.

2. Challenges facing EU pension systems

2.1 Demographic challenges facing pillar I PAYG systems

Demographics and particularly the ageing of the population are the main challenge that pillar I PAYG pension systems are facing, due to the potential impacts in terms of long-term sustainability of pensions and adequacy for providing sufficient protection for the elderly population.

The European population is ageing and the share of the active population is shrinking, which impacts PAYG systems. In 2022, 22.1% of the EU population was aged 65 and over and this share is expected to rise to about 30% by 2070 with improved life expectancy, leading to higher expenditures in terms of pensions[11], healthcare and long-term care. Although trends are similar across OECD countries, the proportion of people aged 65 and over is higher in Europe than in North America or Asia[12].

At the same time, the share of the 20-64 age group (working age population) is expected to fall from 59% to 51% of the total population by 2070. Birth rates are also declining, which may lead to a decline of the overall EU population in the long term. Projections from Eurostat predict a decline of 6% of the total European population between 2022 and 2100[13]. The old-age dependency ratio – *i.e.* people aged 65 and over relative to those aged 20 to 64 – is therefore projected to double in the EU between 2023 and 2080, meaning that there will be much fewer working-age people to pay for the state PAYG pensions of older people in the future. This will also put pressure on public health systems in the coming 20 to 30 years, leading to a potential increase of private health contributions, which will require additional savings to be built before retirement.

This demographic context, combined with labour market specificities (*e.g.* special regimes providing early retirement) and evolutions such as an increasing number of self-employed or part-time workers[14] put into question the future financial sustainability of pillar I PAYG pension systems across Europe, creating the risk of a pension gap. There are moreover potential issues in terms of pension adequacy. The European Commission is expecting that the average state pension as a percentage of the earnings at retirement will fall from 46.2% in 2019 to 37.5% in 2070[15]. There has also been little progress since 2016 to reduce the risk of poverty or social exclusion for older people in the EU, after almost a decade of improvement following the 2008 crisis. In 2021, 16.8% (15.2 million) of people aged 65 and above were still at risk of poverty or social exclusion in Europe,

7. Source OECD Pensions at a glance 2023. Figures are from 2019.
8. Source EU capital markets : a new call to action – New Financial – September 2023 based on OECD figures.
9. As of 31 December 2022, a total of $37.8 Tio was held in US retirement plans and accounts, of which $26.3 Tio was in employer-sponsored plans and $11.5 Tio was in Individual Retirement Accounts (IRAs). Source Congressional Research Service US retirement assets: data in brief September 2023.
10. EU capital markets : a new call to action – New Financial – September 2023.
11. Projections from the OECD estimate that the public expenditure on pensions is due to increase in the EU from 8.5% of GDP in 2020-23 to 13.9% of GDP in 2060 - Source OECD Pensions at a glance 2023.
12. Statistics show that the share of population aged 65 and over is higher in Europe (around 20%) than in North America (17%) and Asia (10%) and this gap is expected to persist in the coming 30 years. An acceleration of the ageing of the population has also been observed since the 90's. Life expectancy is also expected to continue to grow between 2023 and 2050 after a temporary setback caused by Covid-19. Source Allianz global pension report 2023 Reforming against the demographic clock.
13. Source: Understanding EU action on pensions – European Parliament Research Service – October 2023.
14. For example in 2021 nearly 10% of the EU's working population was over 60 and among those working over 65, 40% were self-employed and 59% worked part time.
15. Source The 2021 Ageing report.

according to the European AROPE index (At risk of poverty or social exclusion).

Statistics also show a persistent gender gap in pension protection, although some progress has been observed since 2010, with 44% of women not saving individually for retirement compared to 34% of men, a risk of poverty almost 35% higher for women in old age than for men and a 30% difference in the average pension received by women and by men[16].

2.2 Challenges facing pillar II and III pension schemes

A further challenge, particularly for private pensions, is a potential gap in long-term savings for retirement that is developing in the EU, with 39% of EU citizens surveyed by Insurance Europe in 2023 stating that they are not saving for retirement through a supplementary pension system[17]. According to Eurobarometer data from July 2023, only 23% of EU citizens participate in an occupational pension scheme and 19% own a personal pension product[18], which means that a majority of EU citizens fully depend on statutory pensions for their future retirement income. This has impacts in terms of confidence in pension systems, since only 45% of Europeans are financially confident in their retirement – 37% of women and 47% of men, which is another illustration of the gender gap[19]. Citizens with a supplementary pension also feel more financially confident in their retirement than those without one (53 compared to 37%).

Moreover the awareness of the need to save for retirement is not fully shared among the European population. The Insurance Europe 2023 survey shows that about 26% of those who do not save for retirement are not interested in doing so and 14% state that they do not have enough information.

40% of people surveyed by Insurance Europe also declare that their pension savings are negatively impacted by the current economic environment, leading to a reduction of contributions or delayed savings. The macro-economic environment indeed poses further challenges for pre-funded pillar II and III schemes. Low interest rates have decreased the assets held by pension schemes in nominal terms and more recently high inflation and economic uncertainties have diminished the saving capacity of individuals and the number of new enrolments. The recent rise of interest rates should provide some relief, with lower DB liabilities[20] and higher DC returns.

The macro-economic context can also indirectly affect pre-funded occupational pensions by impacting the workforce or the competitiveness of a given industrial sector or company.

3. EU competencies and on-going pension reforms

3.1 EU competencies on pensions

Pensions are a Member State competence, which means that the EU has no powers to legislate on the design of pension systems or take measures which may affect the fundamental principles or financial equilibrium of national social protection systems

However, the EU can legislate on matters that affect the functioning of the internal market relatively to pensions (free movement of persons, freedom to provide services, protection of consumers) and issues such as gender equality and workers' rights to secure equal pension benefits.

In addition, the European Commission provides Member States with input and non-binding guidance on how pension systems should be designed and implemented in the EU. Several initiatives have been conducted at EU level over the last few years to analyse pension sustainability and adequacy across the Union and the impact of demographic, labour market, digital and green transition trends.

The European Commission also works with Member States through the Economic Policy Committee (EPC) and Social Protection Committee (SPC) on the provision of country analysis and guidance. The Commission runs in cooperation with the EPC and SPC a monitoring cycle publishing reports every 3 years related to ageing (the Ageing report), pension adequacy notably in terms of risk of social exclusion in older age (the Pension Adequacy report) and the challenges facing long-term care systems in the EU (the report on long-term care).

16. Source: Insurance Europe 2023 Pan-European pension survey : key findings, EIOPA Technical advice for the review of the IORP II Directive (September 2023), Eurostat Closing the gender pension gap? (February 2021).
17. See Insurance Europe 2023 Pan-European pension survey.
18. According to figures from the Commission, only 27% of EU citizens between 25 and 59 years old had enrolled themselves in a private pension product in 2019 - Source: Capital Markets Union Pan-European Pension Product (PEPP) FAQ – 4 April 2019.
19. See Article written by P. Hielkema in Eurofi Views Magazine February 2024 Building on past initiatives to address growing pension gaps and EIOPA, Consumer Trends Report 2023, January 2024, EIOPA report probes consumer treatment and financial well-being amid the cost-of-living crisis - European Union (europa.eu).
20. The increase in interest rates has translated into higher discount rates used to calculate the liabilities of DB pension plans, leading to a reduction in the present value of these liabilities.

Retirement policy is moreover embedded in the European Semester economic coordination cycle, which reviews Member State budgets and policy-making. In addition it is part of the scope of issues monitored by the European Parliament, which has published several resolutions in this area, for example a roadmap towards a social Europe (2023) which calls on Member States to preserve pension system sustainability and ensure that their minimum pensions are high enough, or a resolution on employment and social aspects in the European semester (2021) calling on Member States to develop incentives to increase employment opportunities for older workers.

3.2 The current EU body of secondary law on pensions and on-going reviews

Currently, the EU body of secondary law on pensions covers several aspects related to pensions, namely the protection of rights in case of cross-border mobility, consumer protection, gender equality and the single market for occupational and supplementary pensions (pillar II and III schemes).

The **EU regulation on social security coordination**, which applies to pillar I pensions, ensures that people moving between EU countries do not lose out. It mandates that each individual is covered by the legislation of one country at a time (and therefore pays social contributions towards their future pension in only one country), and has the same rights and obligations as the nationals of that country (the principle of equal treatment or non-discrimination). In addition, when claiming pension benefits, the individual's previous periods of insurance, work or residence in other EU countries should be taken into account as necessary. If a person is entitled to a cash benefit from one country, he or she may generally receive it even when living in another EU country (portability of rights).

Concerning occupational and supplementary pensions (pillars II and III), additional rules have been adopted to protect the rights of mobile workers moving between EU countries and to implement minimum common standards[21].

The **IORP II directive** (institutions for occupational retirement provision) adopted in 2016, which is currently under review, aims to ensure the soundness and sustainability of pillar II pension schemes and increase IORP cross-border activity in the EU by setting minimum standards for the governance, risk management, transparency and risk provision of occupational pension schemes in the EU. The objective of the on-going review is inter alia to better take into account the continued shift from DB to DC schemes and the challenges of climate change, diversity and inclusion, improve the governance, prudential standards and information provision of IORPs, and also make sure that existing DB IORPs are properly regulated and supervised. Any decision regarding whether the review should result in a legislative proposal will need to be made by the next Commission.

The IORP sector has developed over time and represents nearly €3 Trillion of AuM in 2021 out of the €4.2 Tio of assets[22] earmarked for retirement in the EU, but the sector is highly concentrated with Dutch IORPs representing nearly 2/3 of this amount, followed by those located in Germany (10%), Sweden (7%) and Italy (6%). In addition the volume of cross-border IORPs is very limited (less than 1% of AuM). One of the main on-going trends is the move from DB to DC schemes, with the latter representing 43% of schemes in 2021[23].

In 2019, the EU also adopted a framework for a **pan-European personal pension product (PEPP)**, a voluntary EU personal pension scheme (pillar III) that offers EU citizens a new option to save for retirement. Complementary to existing national pension regimes and pillar II and III schemes, it allows citizens to continue saving in the same product even when they change residence in the EU. It is however subject to domestic tax rules and incentives. PEPP products should include a default investment option (the Basic PEPP) with costs capped at 1% of the accumulated capital per annum[24] offering a capital protection that can take the form either of a capital guarantee or of other risk mitigation techniques. Transparency on fees and costs is provided via disclosures in a standard Key Information Document (KID) supplied to savers before the purchase.

The PEPP Regulation has applied since March 2022. So far its take-up has been very limited with only one provider in the EU offering PEPPs. Some reasons put forward by product providers for this lack of success include the fee cap and the challenges of implementing capital protection and risk-mitigation techniques for the Basic PEPP

21. Council Directive 98/49/EC of 29 June 1998 on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community and Directive 2014/50/EU of 16 April 2014 on minimum requirements for enhancing worker mobility between Member States by improving the acquisition and preservation of supplementary pension rights.
22. Corresponding to the $4.6 Tio of assets mentioned higher up in the document.
23. Source: EIOPA Occupational pensions in Europe, Cross-border IORPs (November 2023).
24. The potential impact of management fees on savers' total return was the main reason for implementing a fee cap. The OECD highlighted in 2018 that an annual management fee of 1.5% of assets would lead to a reduction of nearly 30% in a person's pension pot at retirement compared to no charges. Source Eurofi Views Magazine September 2019 Olivier Gilvarry, Department of Finance, Ireland.

default option, and also the problems posed by the disparity of national tax incentives and national authorization obligations. The alleged insufficient added value of the PEPP compared to existing domestic pillar III products, beyond portability, is a further issue. The low interest rate environment was also considered by the private sector to be a disadvantage for the PEPP when it was launched. A review of the fee cap is due in 2024. A review of the PEPP Regulation is due in 2027.

3.3 On-going pension reforms at Member State level

To face up to demographic challenges, most European countries have been implementing retirement reforms that adjust the parameters of the PAYG pension system in order to safeguard their sustainability, while ensuring sufficient pension adequacy. Some EU countries have also added mandatory pre-funded components or reserve funds to alleviate the burden on PAYG schemes, but no EU country has shifted to a fully pre-funded system. The objective of these reforms is to mitigate possible fiscal implications from an unsustainable pension system, ensure the continued trust of citizens in the pension system and avoid the imposition of an excessive burden on future generations (with higher pension contributions and lower benefits).

The adjustment of normal retirement age[25] to the improvement of future life expectancy remains the linchpin of these reforms. Longer working lives and later retirement age are being promoted in most Member States by increasing the statutory retirement age, which triggers the payment of the pillar I pensions, and curbing early retirement[26]. These reforms include automatic adjustment mechanisms in some cases that adapt parameters such as pension ages, benefit or contribution rates when demographic indicators such as life expectancy change.

Labour market reforms that provide incentives to work longer have also been implemented by many Member States, with efforts to foster the employability of older workers (retraining, reskilling, improving working conditions), improve possibilities to combine pensions and employment and provide more flexible retirement pathways[27]. In parallel, the role of supplementary pensions (pillar III) has also been promoted in many Member States with specific product frameworks involving tax incentives and employer contributions to encourage workers to save on a voluntary basis for their retirement.

PAYG public pensions (pillar I) and occupational pensions (pillar II) are also expected to become less generous in future, for example with an increase of contribution periods to get a full pension for pillar I pensions and a progressive shift from DB to DC for pillar II schemes.

Increasing contributions of workers to the pension system is not the solution chosen in most cases, as it may lead to an increase of labour costs, decreasing economic competitiveness, and could trigger transfers of workers to the more informal market, particularly if the expected future pension payouts do not increase.

3.4 Actions proposed in the context of the Capital Markets Union (CMU)

Supporting people in their retirement is one of the actions of the September 2020 CMU action plan set out by the European Commission as part of the objective to increase the level of retail investor participation in capital markets.

Proposals were made by the Commission in three main areas: auto-enrolment, pension dashboards and pension tracking systems.

- Auto-enrolment

A study was published by the Commission in November 2021 on **auto-enrolment** (AE) mechanisms that enrol individuals automatically in a supplementary pension scheme, unless they opt-out. The objective is to stimulate participation in these schemes when it is not mandatory. A number of best practices were identified at the international level for the successful implementation of AE including: mandatory employer contributions to the AE scheme, the possibility for employees to contribute to pension schemes without having worked for their employer for a minimum period of time, the presence of a default fund with capped costs and a life-cycle investment strategy and a transparent presentation of charges and costs.

- Pension dashboards

The Commission proposed the development of **pension dashboards** in the September 2020 CMU action plan in order to facilitate the monitoring of pension adequacy in Member States by policy-makers and the tackling of possible shortcomings,

25. Age at which a person is eligible to full retirement benefits from all mandatory components.

26. The average normal retirement age is 64 for people retiring at present in OECD countries and it is due to increase to 66 for currently active people. A similar evolution is observed in the EU, with the current retirement age ranging from 62 to 67 across Member States and due to increase to a range of 64 to 70 in the future years. Source OECD Pensions at a glance 2023.

27. At OECD level such reforms have been successful with the employment rate of 55-64 year-olds reaching 64% in 2023, almost 8 percentage points higher than a decade ago (OECD Pensions at a glance 2023). In the EU, significant progress has been made in increasing older workers' participation rates (age group 55-74), whose participation rate grew from 31.6% in 2010 to 39.1% in 2018 (Joint EPC-SPC paper on pensions 2019). Additional efforts may however need to be made to increase labour productivity, as increasing strongly labour participation among the shrinking group in age of working may be challenging over the long term.

with more detailed information on occupational pension schemes in particular. A projection of public pension spendings of all Member States over the next 50 years and of replacement rates over the next 40 years is already conducted in the context of the Ageing report, but the coverage of pillar II and III pensions is only partial in these projections and assessments[28].

EIOPA delivered a technical advice to the Commission in December 2021 that advises a gradual approach to the development of these tools at European level, given the complexity of collecting the necessary data and ensuring its comparability with differing national pension, social security and tax systems. The advice is to develop a visual pension dashboard presenting a complete set of indicators drawn from the European Commission's triennial Ageing, Pension Adequacy and Fiscal Sustainability reports that may allow the enhanced analysis and comparison of occupational pension schemes across the EU. This approach would start in the short term with existing pension data, before newly collected data on private occupational and personal pensions is added to complete the dashboards with more detailed pension projection data.

- **Pension tracking systems**

The Commission also recommended the development of best practices for the setting-up of national **pension tracking systems** (PTS) which allow citizens to benefit from an overview of all their pension entitlements in one place in an accessible and understandable way. The objective is to help citizens understand what total income they can expect in retirement and evaluate whether it will be sufficient.

EIOPA provided the Commission with technical advice in December 2021 focusing on PTS best practices to help member states that do not have a PTS in place (20 member states at present) to set one up. EIOPA recommended the setting up of digital PTSs using a secure digital ID system that should be free of charge for users and providing information at least on projected future retirement income at the expected retirement date and data on accrued entitlements. A progressive implementation approach is proposed, given the variety of pension systems in the EU, with recommendations on the way the information should be presented for it to be simple and understandable and on how the governance of PTSs should be organized.

28. About a dozen member states provide projections for non-public pension schemes (pillar II and III) as a voluntary input to the Ageing report. In addition since 2012 the Commission and the member states also cooperate in making adequacy projections in the Pension adequacy report but data on pillar II and III pensions is limited at present.