
Governance of the German Pension System

Part I (a)

Overview: System Elements and Coordination

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Support to the State Social Protection Fund on the introduction of funded elements within the insurance-pension system, establishment of non-state pension funds and development of the legal framework for regulating their activities

Activity 4.1

In-depth presentation of the state pension system of the EU MS to relevant SSPF staff and other stakeholders

21-22 July, 2014

- **State Social Protection Fund**
- **80 H. Zardabi Ave.**
- **Baku, Republic of Azerbaijan**

Institutional Design

The German Pension System

- **Multi Pillar System**
- **Focus on gainful occupation**
- **Coverage: Stratification along occupations and professions, at least in the first pillar**
- **Funding: Pay-as-you go: first pillar (mostly); Full funding: second and third pillar (mostly)**
- **Fragmented !**
 - **Path dependency of pension system development**
 - **Impact on labour market flexibility.**
 - **Requires co-ordination across schemes and pillars**

Key Features

Distribution of Responsibilities

State pension

- Social Insurance (Main System)

Occupational Pensions

- Employees' individual rights to Occupational Pension Saving
- Employer Responsibility

Private Pensions

- Private Market Commercial Provision
- Stock Corporations
- Mutual funds

Coverage

Coverage is Key for Adequate Pension Provision

- **Mandatory participation in first pillar schemes**
 - Employees
 - Some groups of the self employed
- Automatic enrolment
- **Active choice and commitment products**
- **Voluntary enrolment and matching (tax allowances)**
 - Second and third pillar schemes
- Simplification and planning tools
- Matching contributions (employer or state)

The German Pension System: Coverage

Third Pillar	Private Pension Insurance								
Second Pillar	Occupational Pensions							Chambered Professions	Civil Servants
First Pillar	Farmers' Pension Provision	Statutory Pension Insurance							
		Insurance of Craftspeople	Insurance of Artists and Publicists	Insurance of Vulnerable Groups of the Self Employed	Voluntary Insurance	Miners	Employees		
Zero Pillar	Means tested Income Maintenance at Subsistence Level								

Schematic diagram without legal implications

Principles of Management

Key Features

Decision Making

State pension

- Self Administered Corporations under Public Law

Occupational Pensions

- Five vehicles for Occupational Pension Provision

Private Pensions

- Market Allocation
- Competition
- Transparency
- Market Efficiency

Principles of Regulation and Supervision

Key Features

State pension

- Federal legislation
- Public supervision

Occupational Pensions

- Labour law
- Corporate law
- Financial market law

Private Pensions

- Financial market law
- Consumer protection

Principles and Methods of Funding

The German Pension System: Funding

Full funding: green, PAYG: yellow

Third Pillar	Private Pension Insurance								
Second Pillar	Occupational Pensions							Chambered Professions	Civil Servants
First Pillar	Farmers' Pension Provision	Statutory Pension Insurance					Voluntary Insurance		
		Insurance of Craftspeople	Insurance of Artists and Publicists	Insurance of Vulnerable Groups of the Self Employed					
Zero Pillar	Means tested Income Maintenance at Subsistence Level								

Schematic diagram without legal implications

Key Issues

- **Diversification of funding risk: Pay-as you-go and full funding**
- **Demographic change: ageing of the population**
 - **Shrinking funding base, reduced labour force**
 - **Longevity risk**
- **Low interest rate environment (Central Bank policies)**
- **Search of yield**
- **Increased investment universe and more financial instruments**
- **NEW: Infrastructure investment**

Principles of Operations

Key Features

- **Separation of functions: legislation, implementation, management, supervision, juridical control**
- **Consumer choice and protection in second and third pillar schemes**
- **Safety first principle in investment**

Performance and Results

Outcomes and Results

- **Stability of funding, even in times of a financial crisis**
- **Safety first and diversification of funding methods and asset allocation**
- **Indexation of financial benefits**
- **Adequacy of benefits ...**

Challenges

Threats to Multi-Pillar Pension Provision

- **Savings capacity of households**
- **Voluntary coverage and coverage gaps in second and third pension pillars**
- **Integration of plans and schemes : entitlements , poverty alleviation, incentives to save**
- **Financial market failures**
 - **risk bearing capacity**
 - **duration and roll over of financial instruments**

Summary: Current Risk Assessment

	Statutory Pension Insurance	Occupational Pension Provision	Private Pension Provision (Assurance)
Default risk	No	No	No
Rate of return risk	Yes	Yes	Yes
Cost risk	Yes / No	Yes / No	Yes
Adequacy or Purchasing power risk	Yes	Yes	Yes

Summary: Sources of Risk (1)

	Statutory Pension Insurance	Occupational Pension Provision	Private Pension Provision (Assurance)
Default risk	-	Large insolvencies	Insolvency of financial institutions
Rate of return risk	Unemployment Wage development Demographic shift	Economic downturn, low profitability	Monetary policy Low market rates (longevity)

Summary: Sources of Risk (2)

	Statutory Pension Insurance	Occupational Pension Provision	Private Pension Provision (Assurance)
Cost risk	Deviations from actuarial principles	Closing of schemes	Regulatory shortcomings, product differentiation roll-over risk
Purchasing power risk	Inflation (after ...) inadequate or missing indexation		

Vielen Dank!

Thank you very much!

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