Governance of the German Pension System Part I (a)

Overview: System Elements and Coordination

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Twinning Project AZ/13/ENP/SO/24

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

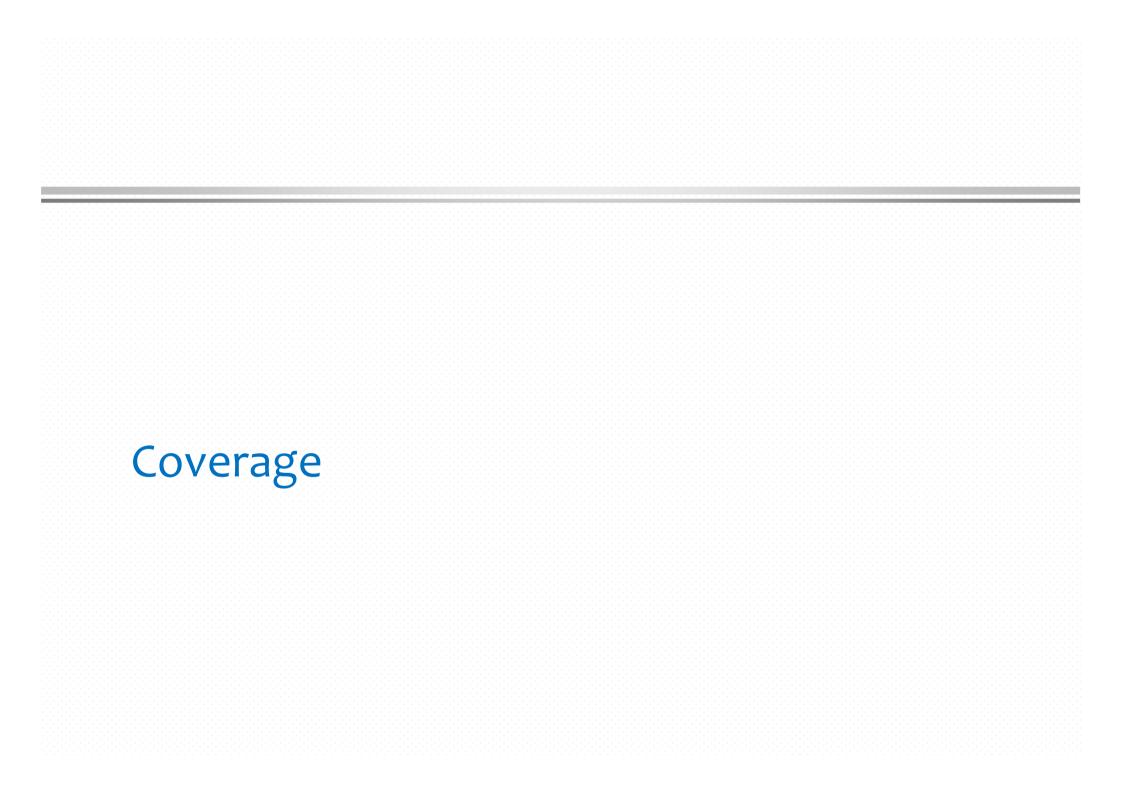
 Social Insurance (Main System)

Occupational Pensions

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

Private Pensions

- Private Market Commercial Provision
- Stock Corporations
- Mutual funds



Coverage is Key foe 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							
First Pillar		Statutory Pension Insurance						
	Farmers' Pension Pro- vision	Insurance of Craftspeople	Insurance of Artists and Publicists	Insurance of Vulner- able Groups of the Self Employed	Voluntary Insurance	Miners	Employees	Chambered Professions
Zero Pillar	Means tested Income Maintenance at Subsistence Level							

17.11.2013

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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

18.07.2014

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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							
	Farmers' Pension Pro- vision	Statutory Pension Insurance						
First Pillar		Insurance of Craftspeople	Insurance of Artists and Publicists	Insurance of Vulner- able Groups of the Self Employed	Voluntary Insurance	Miners	Employees	Chambered Professions
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

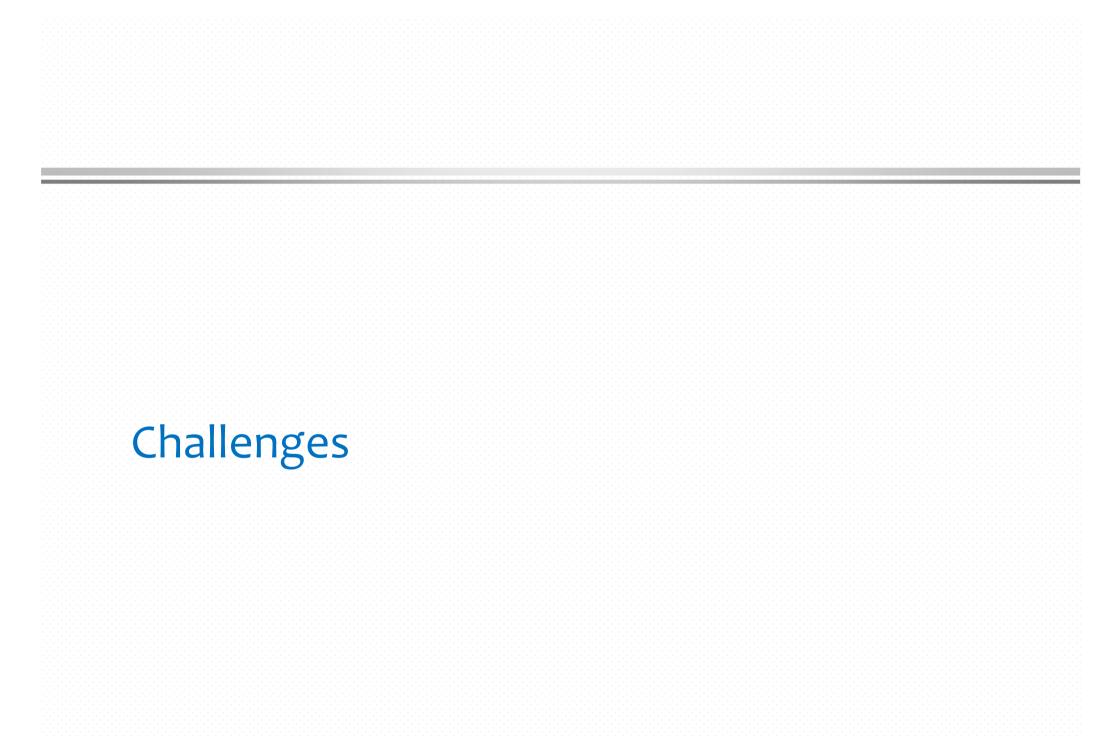
Key Features

- 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 ...



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
 - o 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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