

THE ROLE OF WORKPLACE (OCCUPATIONAL) PENSIONS TO CONTRIBUTE TO ADEQUATE RETIREMENT INCOME PROVISION

MARKUS SAILER

German Pension Insurance
Department for
Research and Development
Berlin, FRG

Association for
Social Security Policy and Research
(GVG)
Cologne, FRG



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Pension Products have Special Features

- Role and tasks of pension schemes in general perspective
 - Support individuals (families) in the management of financial risks related to retirement and old age (surviving dependents, invalidity)
 - Retirement products are at the crossroads of societal values (social policy targets) and market imperatives
- Conclusion: Retirement products are different from financial instruments for pure wealth creation
 - More regulation is recommended
- What is the role and place of workplace /occupational pension schemes?
 - Motivation for employers and employees

Motivation for Employers: Attraction of Employees

- Management of staff through a structured remuneration package
 - Attract employees (new entrants or from competitors)
 - Retain employees and limit labour turnover
 - Instrument to remove redundant older, less productive workers
- Historic development
 - Occupational pensions were established as an instrument to attract employees to the company during periods of and despite statutory wage freeze (wage stop)
 - USA: wage stop during World War II
 - UK: wage stop during periods of high inflation in the 1970ies

Motivation for Employers: Limits and Threats

- Lock-in stipulations of the pension plan
 - Waiting period before enrolment into the plan
 - Vesting periods before acquired rights became irrevocable
 - Limited portability of acquired pension rights in case of quitting
- Legal limits to impose lock-in stipulations
 - General legal mandate to establish occupational plans (including management by an external pension fund)
 - Integration of occupational pensions into multi-pillar pension provision
 - Equal treatment requirements
 - Employee contribution

Motivation for Employees: Cost saving and Security

- Retirement provision: individual account or collective provision
 - Employer co-sponsoring
 - Risk pooling
 - Adjustment of plan provisions to employees' earnings risks specific to the company or industry
 - Tax deferral (and finally tax saving in a progressive tax schedule)

Employers and Employees: Common Interests

- Compensation of employees: Gross wage or remuneration package
 - Alignment of the interest of the company and the employee in the long-term prosperity of the company
 - Pension provision for the needs specific to particular companies or industries.
 - Example: Early retirement pension for hazardous work to bridge the period until the statutory retirement age is reached.
 - Cost saving through risk pooling and economies of scale

Workplace Pensions

- Structure of benefits

- Lump-sum payments or phased withdrawal plans
- Inflation protection through benefit escalation
- Caution: Occupational plans are not best placed to cover longevity risk
- Annuity provision requires a risk transfer to an external annuity provider

Coverage of Financial Risks during the Pay-out Phase through Workplace Pensions

| | Financial risk | Type of product |
|----------------------|-------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
| Liquidity (Bequests) | Flexibility to meet unforeseen expenditures, e.g. medical treatment, long-term care | Lump-sum (single) payment |
| Adequate income | Alleviate poverty, provide adequate replacement of earnings | Programmed withdrawals: series with fixed or variable instalments: Term pension |
| Life-long income | Longevity risk | Periodic fixed or variable payment until the end of the annuitants live: Annuity or life pension |
| Common risk | Inflation | Escalating nominal benefit (annuity) |
| | (Re-)Investment risk | |
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Summary: Risk features of retirement products

| | Risk Protection | | | Other Benefits | |
|-----------------------------------------------------------|-------------------|------------|-----------|----------------|---------|
| | Longevity | Investment | Inflation | Flexibility | Bequest |
| Lump-sum payment | No | No | No | Yes | Yes |
| Term annuity | No | Possible | Possible | No | Yes |
| Life long withdrawal plan | No | No | No | No / Yes | Yes |
| Variable life annuity + minimum payment guarantee + bonus | Possible / shared | Shared | Shared | No | No |
| Variable life annuity, unit linked | Shared | No | No | No | No |
| Fixed nominal annuity | Yes | Yes | No | No | No |
| Escalating nominal annuity | Yes | Yes | Partial | No | No |
| Fixed real life time annuity | Yes | Yes | Yes | No | No |

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Summary and Conclusion

- Role of workplace pension is to cover risks specific to the company or industry
- The design of the benefit should respect the limits of employers to act as an annuity provider
- Requirements of Governance, management and implementation
- Specific requirements of regulation and supervision

Sağ olun!

Thank you very much!

Vielen Dank!