Over the next few years all the countries in Western Europe will have to face challenges of comparable size related to the economic and social impact of the arrival at retirement age of the baby-boom generations, a fact further exacerbated by the increase in life expectancy. All these countries will be confronted with this challenge, irrespective of differences between them in terms of demographic growth or retirement pension systems.

Fully aware of this impending deadline, they have all launched reforms of their retirement systems with a view to providing their future pensioners with decent replacement income while simultaneously striking a fair balance between the various pension schemes. Although they are often extremely difficult to compare, these new systems nevertheless share three points in common: the increase in the age of retirement, the creation of reserve funds, and the introduction of supplementary funded schemes based on the British pension fund system, which is considered as a reference model in this area despite certain difficulties that it has faced. Our industry, therefore, is liable to find itself more deeply involved in the management of pensions.

We felt it would be useful in our 20th Newsletter to offer you a panorama of the principal reforms adopted in Europe. Should you require further information about this topic, I invite you to contact your usual SCOR VIE correspondent.

United Kingdom

Group funded pension schemes dominate the market.

There are historical reasons for this. The compulsory, pay-as-you-go unfunded basic state pension (1st tier) has for long been extremely limited in scope; the pension benefits are also paid on a flat-rate basis.

In 1978, a new unfunded additional state pension was introduced—the State Earnings Related Pension Scheme (SERPS)—but its monthly benefits were gradually reduced. In 1986 the State started to withdraw from this scheme by encouraging individual employees to opt out of the state system and into an occupational pension scheme or a personal pension plan. Unfortunately, both of these pension schemes were frequently sold in a rather unscrupulous manner. For certain contributors near retirement, the fact of opting out of the state system resulted in a significant reduction in their pension benefits owing to the high management charges and the short period of contributions to the new scheme. These practices encouraged the financial services regulatory body, FSA, to compel insurance companies to "reinstate" the entitlements lost by contributors. This proved to be extremely expensive for the insurance industry: £12 billion (this is what is known as the "pension misselling" scandal).

SERPS was replaced in 2002 by the "State Second Pension" (S2P). This new scheme favours people earning less than £3,900 per year by doubling their previous SERPS entitlements. People earning more than £24,600 keep their previous entitlements unchanged. A sliding scale is used between the upper and lower limits.

The second tier is based on funded pension schemes. This system is not compulsory and chiefly consists of "occupational pensions" covering approximately 11 million employees. The State and the trade unions both encouraged the adoption of this system: the former by offering tax incentives and the latter by recognizing the benefits paid out under these schemes as deferred earnings. It should be emphasized that these retirement benefits may be supplemented by bereavement allowances, widow's pensions or incapacity allowances, sickness or "critical illness" benefits. By mid-2000, the present value of pension fund liabilities amounted to approximately £860 billion.

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1 According to the 11th survey of the Government Actuary's Department, April 2003
Pension funds are simple to run but the regulations governing them have been tightened up on several occasions: pension fund assets are managed by Trusts and responsibility for liabilities and the suitability of investments fall to the representatives of these Trusts, the Trustees. The pension funds may offer defined benefits (final salary scheme) or consist of defined contributions (money purchase). The latter are preferred today because the pension funds are no longer willing to be required to cover the gap between their liabilities and their investments following the successive collapses in the financial markets. Employees’ contributions may be deducted from the gross salary and may result in tax relief of up to 40% of the contributions paid in. When the contributor retires—and depending on the amount of savings built up—the accrued proceeds are transferred to an insurance company and the retiree may then take out an insurance contract paying a life annuity.

The so-called “Stakeholder pension” scheme was launched in 2001 to supplement the S2P system. It is specifically targeted at low wage earners. Companies with more than 5 employees may offer it under certain conditions:

- There must be no “occupational scheme” already existing in the company, or
- The employees must have no alternative arrangement meeting a number of minimum standards.

Management charges in each year must not exceed 1% of the total value of the fund, and the scheme must be a money purchase arrangement. Stakeholder pension schemes are distributed by insurance companies as well as other financial institutions, unions or mutual companies. The scheme is governed by an extremely simple tax regime limited to an annual ceiling or to existing savings and the age limit specified in the retirement contract.

After one year in existence, only 300,000 employers had joined one of these schemes, representing just over 800,000 individuals. This lack of success may be explained by the 1% annual administration charge sharply criticized by the management companies.

The Netherlands

After the United Kingdom, the Netherlands is the most highly developed European country as far as pension funds are concerned with approximately 1,000 pension funds and nearly 22,000 different retirement schemes. It was the 1952 ‘de Pensioen- en spaarvondsen-wet’ law (currently being reviewed and updated) that introduced these different types of retirement plans. These pension systems provide additional benefits on top of the basic legal pension (AOW), paid in the form of periodic annuities. There exist two forms of interlinked pension funds:

- “Industry pension funds”: these funds are linked to industrial sectors and are compulsory as soon as a collective agreement is adopted for the sector in question. This type of pension fund is available for 90 to 95% of all industrial sectors. The amount of pensions paid out may be subject to limits, in which case a company pension fund may provide additional benefits.

- “Company pension funds”: only the employees of a company or group may be members of these funds. They are run as a separate entity from the company, and either replace or complement the benefits paid by an industry pension fund. All employees are entitled to pay in more than the company’s contributions to ensure a higher level of pension benefits.

These two types of funds cover approximately 80% of all workers. The remaining 20% are covered by retirement plans taken out with life assurance companies. The size of this sector can be gauged by the amount of investments: assets worth more than €500 billion are currently invested by these different pension funds. This can be explained, firstly, by the existence of powerful tax incentives and, secondly, by the inclusion of retirement planning in companies’ remuneration policies.

Germany – The “Riester” pension

The “Riester” pension, which came into force in 2002, is a voluntary, funded pension system. This system seemed to enjoy a bright future but, after two years in existence, its success has not lived up to expectations: 2.6 million contracts were taken out in 2002 but, at the end of 2003, this number had fallen to 500,000 new contracts. This lack of popular success may be explained, in part, by the fact that the planned tax incentives have a very limited impact on the lowest incomes that bear little, or no, taxation.

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1 Source: ABI annual report
2 If you would like further details about the creation of this system, we invite you to consult our 8th Technical Newsletter, dated November 2002: The German Pension Fund.
Italy

In Italy, supplementary pensions exist either in the form of pension funds organized per professional category or on the basis of individual subscription, or in the form of individual insurance policies (FIP).

Pension funds have existed in Italy since 1993. The funds set up for workers in a particular sector of industry (e.g. the chemical industry) are linked to the contracts of employment; insurance companies only start managing these funds when the retirement benefits are paid out.

"Open funds" are run by insurance companies, banks, and financial management companies. They are offered to individuals unable to join a "professional category" pension fund (e.g. self-employed workers).

The FIP is an individual insurance policy, either denominated in units of account or adjusted at a fixed rate, enjoying the same fiscal advantages as pension funds and subject to the same constraints. Individual retirement plans include a tax allowance of up to 12% of annual income (with an upper limit of €5,164.57). These contracts charge a single annual premium whose size varies in line with the policyholder's income. At maturity, which corresponds to retirement age, the policyholder usually chooses an annuity to continue enjoying the fiscal advantages. 50% of the accrued savings may be paid out in the form of a lump sum benefit.

The size of the life annuity is not guaranteed but the coefficients for conversion into an annuity are guaranteed during the final three years of contributions.

France

Certain sections of the population enjoy access to the funded pension system available in the French market.

The Préfon-Retraite and CREF retirement schemes are reserved for civil servants. The so-called "Madelin law" of 1994 introduced a voluntary pension scheme for the self-employed while private-sector employees have access to pension funds set up within their companies (subject to a number of conditions) under the terms of certain articles in the French Tax Code.

A universal funded pension system has now been adopted in France: the "popular retirement savings plan" (PERP) introduced by the so-called "Fillon law" dated August 21, 2003 and available since the spring of 2004.

This savings contract is used to buy a life annuity when the policyholder retires and enjoys tax relief whereby the amounts paid into the contract can be deducted from taxable income provided they do not exceed 10% of salary (with an upper limit of €23,769 in 2004). What is more, two essential features make it different from other savings products:

- The savings period is liable to be longer than thirty years.
- The contract must be converted into a life annuity.

There are two main types of PERP contracts:

- Euro-denominated contracts: the savings deposits are chiefly invested in bonds. Gains are accrued year after year but the investment will enjoy a lower rate of return.
- Diversified euro-denominated contracts: the savings deposits are invested in two clearly distinct sections (a "bond" section, and a section comprised of more risky assets) making it possible to take advantage of increases in the equity markets and to anticipate a higher rate of return than that provided by euro-denominated contracts.

As many safeguards as possible have been introduced to protect investors. Subscription is only possible through the Popular Retirement Savings Group (GERP), an association governed by a Board of Directors and a Supervisory Board. The GERP oversees the management of the retirement plan, the information provided to investors and the allocation of profit-sharing by the insurance company responsible for administering the PERP.

The assets invested in the PERP are also carefully ringfenced and deposited with an external trustee to maintain a strict separation between the general assets of the insurance company administering the scheme and the specific assets of the retirement savings plan. What is more, a "progressive security investment" mechanism has been introduced: as the investor approaches retirement age, the insurer is required to guarantee a minimum amount of the funds invested in the PERP. The law also allows each investor to transfer his or her individual entitlements from one PERP to another.

The Fillon law also introduces a funded pension system within companies: the Group Retirement Savings Plan (PERCO). The fiscal advantages are less generous for the employee than in the PERP but the contract is more flexible to the extent it allows the employee retiring from full-time employment to choose his or her exit strategy.

After only a few months in existence, one million contracts have already been sold, mainly by bancassureurs. A relatively young section of the population (aged 30 to 40) seems to be attracted by these new contracts, undoubtedly in response to their growing awareness of the need to save for their retirement.
The State retirement pension system is chiefly based on an unfunded “pay-as-you-go” system.

The second tier pension system consists of company pension funds as in the United Kingdom, mainly organised on the basis of defined contributions. Although the State actively encourages individual savings, the lack of product flexibility has prevented the development of this solution. The principal drawbacks include:

- The impossibility for investors to transfer their personal retirement savings to their company pension plan.
- The impossibility to contribute to a personal retirement policy at the same time as a company retirement contract.
- The impossibility for an employer to pay for an individual policy.

Introduced at the end of 2003, the Personal Retirement Savings Account (PRSA) is a defined contribution investment fund open to everyone, irrespective of their employment status, as well as to companies. The upper age limit for leaving the plan can vary between 55 and 70.

The upper limit on contributions, as far as tax advantages are concerned, is 0.5% for each year of the investor’s age starting at 15%, and rising to a maximum of 30%, of net relevant earnings. Employees can also ask for their contributions to be deducted directly from their salaries, but they cannot leave an existing company pension fund.

Up to 25% of the savings (up to a maximum of €32,000) may be used as security for a personal loan. As this product has only just been launched, it is still too soon to comment on its success.

It can be seen from the above that European governments are, at the moment, only faced with the problem of setting up and distributing these new products. The future will reveal any malfunctions and whether it is necessary to make regulatory, fiscal and/or technical adjustments related to the complexity of existing solutions. But the most striking fact is the awareness among Europeans of the need to supplement their basic state pensions, chiefly with the help of funded pension schemes.

Solutions provided by SCOR Vie for questions related to pension funds

The pension funds usually include death benefit that they often do not wish to cover themselves. SCOR Vie offers its customers the possibility to obtain annual cover against an exceptional deviation in mortality on the basis of previously negotiated criteria.

Certain pension funds also offer occupational disability insurance. SCOR Vie has acquired substantial experience of this type of cover and, in addition to its reinsurance activities, offers customers its support in the introduction and administration of these products.

The pension funds in certain countries include the obligation to convert the accrued savings into a life annuity and, therefore, want to limit their exposure to longevity risk. SCOR Vie, via its Research & Development Centre devoted to Longevity and Mortality Insurance (CERDALM), provides its customers with solutions tailored to their needs.

Lastly, in a difficult economic and financial environment and faced with an increasingly large number of regulatory constraints, SCOR Vie is also in a position to satisfy the expectations of pension funds looking for ways to lighten their solvency margin requirements.

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