



THE EVOLUTION OF PENSION SYSTEMS AND THE CHALLENGES AHEAD

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THE START OF PENSION SYSTEMS



Beginning of pensions

- Many systems started with minimum payment levels at the end of the 19th century.
- Life expectancy was only a couple of years at the point of retirement.
- Public sector workers normally covered first.
- When coverage was extended to the private sector pensions were often separate and less generous than for the public sector.
- Self-employed joined much later.



CURRENT DESIGNS



All systems are different

	First tier				Second tier			First tier				Second tier	
	Residence-based		Contribution-based		Basic	Private		Residence-based		Contribution-based		Public	Private
	Basic	Targeted	Basic	Minimum				Basic	Targeted	Basic	Minimum		
Panel A. Latest legislation applying to future retirees entering the labour market in 2022 at age 22.													
Australia		✓				FDC	Luxembourg			✓	✓	DB	
Austria				✓	DB		Mexico	✓			✓		FDC
Belgium				✓	DB		Netherlands	✓					DB [q]
Canada	✓	✓			DB		New Zealand	✓					
Chile		✓				FDC	Norway		✓			NDC	FDC
Colombia				✓	DB	FDC	Poland				✓	NDC	
Costa Rica					DB	FDC	Portugal				✓	DB	
Czechia			✓	✓	DB		Slovak Republic				✓	Points	
Denmark	✓	✓			FDC	FDC [q]	Slovenia				✓	DB	
Estonia			✓		Points		Spain				✓	DB	
Finland		✓			DB		Sweden		✓			NDC + FDC	FDC [q]
France				✓	DB + Points		Switzerland				✓	DB	DB
Germany					Points		Türkiye				✓	DB	
Greece	✓				DB + FDC		United Kingdom			✓			FDC [q]
Hungary				✓	DB		United States					DB	
Iceland	✓	✓				FDC [q]							
Ireland			✓				Argentina			✓	✓	DB	
Israel	✓		✓			FDC	Brazil				✓	DB	
Italy					NDC		China				✓	NDC + FDC	
Japan			✓		DB		India				✓	DB + FDC	
Korea		✓	✓		DB		Indonesia				✓	DB + FDC	
Latvia				✓	NDC + FDC		Saudi Arabia				✓	DB	
Lithuania			✓		Points		South Africa		✓				
Panel B. Current legislation applying to new retirees in 2022 where different from Panel A*													
Chile		✓		✓	DB	FDC	Mexico				✓	DB	
Estonia			✓		DB / Points	FDC	Norway	✓	✓			DB	FDC
Greece	✓				DB + NDC		Poland				✓	DB / NDC	
Italy				✓	DB + NDC		United Kingdom			✓		DB	



Basic pensions are reasonably common

- 17 OECD countries have a basic pension
 - Eight of these are based entirely on residence rather than contributions
- But only two countries do not have a mandatory/quasi-mandatory earnings-based scheme in addition
 - Ireland
 - New Zealand (residence based basic)



Early or flexible retirement is possible but not common

- Basic pensions usually restricted to normal retirement age at the earliest.
- CZE, GRC, JPN, KOR and LUX have more flexibility.
- CZE, JPN and KOR have early retirement with penalty in combination with earnings related.
- GRC and LUX permit retirement without penalty after 40 years.
- Neither NZL or IRL have any early retirement option.



Differing approaches have been planned

- Automatic links between retirement age and life expectancy: Denmark, Estonia, Finland, Greece, Italy, Netherlands, Portugal, the Slovak Republic and Sweden.
- Or predetermined increase: Czech Republic by two months every year from 2035. Poland from age 65 to 67 for men and 60 to 67 for women. Ireland and UK increasing to age 68.



Decisions are reversed, even before they even start

- Czech Republic – No further increases planned once retirement ages equalise at 65.
- Poland – reversed initial increases and retirement ages remain at 65 for men and 60 for women in the long-term.
- Slovak Republic – suspended planned increases after age 64, but have reversed again.
- Ireland – No longer increasing beyond age 66.



More risk is being passed to the individual than the state

- Prevalence of defined-benefit schemes is falling (21 countries have DB or points).
- Defined-contribution are the new norm during reforms
- DC (10 countries)
- NDC (5 countries)
- If not mandatory, then auto-enrolment is an option e.g. NEST or KiwiSaver.



Case study: Sweden

- Passed legislation to move from DB to NDC + FDC in 1994.
- System was introduced in 1999.
 - Those born in 1937 or earlier remain in the old system
 - Those born in 1954 or later are entirely under the new system
 - Gradual transition from the old system for those born between 1938 and 1953



Case study: Sweden (2)

- Gained political consensus before introduction.
- Public schemes are universal.
 - Covers private sector, public sector and self employed
- Contributions are paid on earnings throughout the working life without an age limit.
- In both schemes, individuals' contributions constitute their own account values, which are annuitised at retirement.



Case study: Sweden (3)

- Tax-financed guarantee minimum pension.
 - means-tested housing supplement in addition
- Fixed amount benefit.
- Income tested against the NDC.
- Withdrawal rate of 48%.
- Orange envelope every year.



Case study: Sweden (4)

- Further reforms all have political agreement before being implemented thereby removing pensions from the political landscape.
- Cross party agreement on retirement age increase – Nov 2017
 - Approved by parliament in May 2022.
 - Linked to life expectancy increases from 2026



AUTOMATIC ADJUSTMENT MECHANISMS



What are Automatic Adjustment Mechanisms?

- AAMs are predefined rules that
 - automatically change pension parameters or benefits
 - based on the evolution of an indicator
- AAMs protect pension systems
 - against demographic, economic and financial uncertainties
- AAMs can help uphold financial sustainability



Why use AAMs?

- Compared to discretionary reforms, AAMs are
 - **less erratic** \Rightarrow reduce the risk of under- or overshooting the mark
 - more **transparent**
 - more **equitable** across generations
- AAMs reduce
 - **political cost** of maintaining or improving **financial sustainability**
 - **need for subsequent reforms**
- AAMs can only provide financial sustainability **if they are politically sustainable**
 - need for wide political agreement on their introduction and design that avoids harsh adjustments
- Policy-makers retain **full control** over pension system

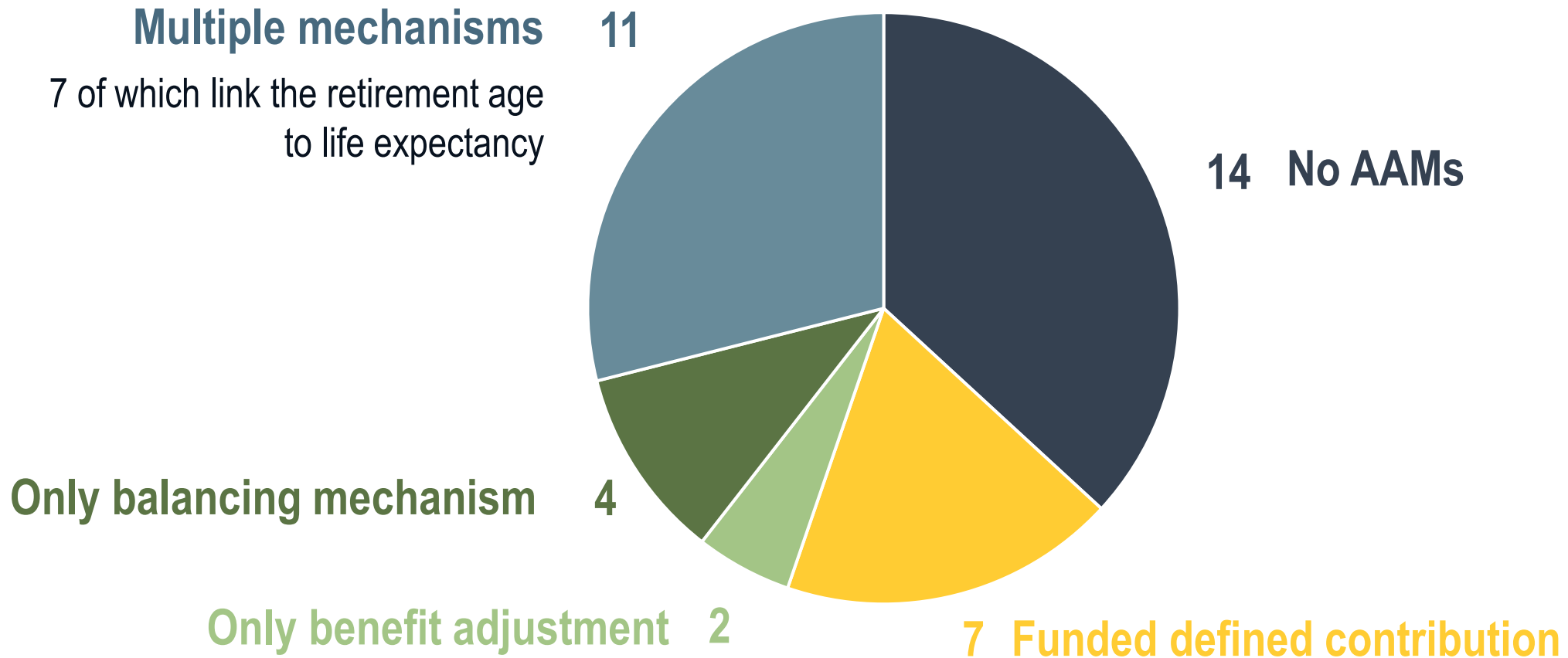


Examples of AAM

- In 1930s introduced automatic rules of indexing pensions to prices in Denmark.
- In 1950s, the Netherlands and France introduced rules to index pensions to wages; periods of high inflation following oil crisis induced links of benefits
- Population ageing induced further adjustments:
 - Links of benefits to changes in life expectancy, to some funding ratio, to changes in the wage bill
 - Links of retirement ages to changes in life expectancy
- The triple lock in the United Kingdom




AAMs exist in about two-thirds of OECD countries





AAMs adjusting benefits and/or retirement ages

	Adjusts to life expectancy	Adjusts to size of the working population
Funded defined contribution <ul style="list-style-type: none">• Annuities: benefits adjusted• Lump sums: people manage own longevity risk	•	
Notional defined contribution <ul style="list-style-type: none">• Italy, Latvia, Poland• Norway, Sweden	• •	•
Benefit adjustments <ul style="list-style-type: none">• Finland• Estonia, Greece, Japan, Lithuania	•	•
Retirement age adjustments <ul style="list-style-type: none">• Full: Denmark, Estonia, Greece, Italy• 2/3rds: Finland, the Netherlands, Portugal	• •	



Automatic balancing mechanisms

- Adjustments to life expectancy and size of the working population insufficient to ensure financial balance
 - Need to be complemented by a balancing mechanism
- Balancing mechanisms aim to balance pension budget
 - Finland, Germany, the Netherlands, Sweden, the United States
 - Canada: backstop
 - Default adjustment if no political agreement on alternative way to restore balance
- Finland and Sweden have the most effective AAMs
 - Sweden complements NDC adjustment with balancing mechanism
 - Finland complements retirement-age link with benefit adjustment and if needed with balancing mechanism



Instead of increasing retirement ages benefits can be changed

- Defined contribution plans automatically adjust by calculation of annuities.
- Similarly for Notional Accounts Plans: Italy, Latvia, Norway, Poland and Sweden
- Sustainability factors in defined benefit plans: Finland
- Adjustments to the "dependency ratio" or the financial balance: Germany, Spain, Portugal and Sweden



When (not) to use AAMs?

- AAMs should be used to adjust pension systems to future trends
 - they are not a substitute for bold measures to tackle structural financial imbalances
- If a pension scheme is financially unbalanced
 - first restore financial balance
 - Needed measures are independent of the evolution of any indicator
 - Discretionary measures or long-term planning, i.e. scheduled adjustments over longer periods
 - then use AAMs to adjust for future trends



Case study: Spain

- Some might be tempted to consider that because an AAM is in place all pension problems are solved.
- However, not all AAMs are well designed, and badly designed AAMs may generate opposition resulting in their cancellation or reform.
- Moreover, not all AAMs are equally suitable to tackle the specific challenges a country faces.
- Supplementary reforms might be required in order for the mechanism to fulfil its objectives.



Case study: Spain (2)

- AAMs designed to mask cuts in pension benefits in real terms are more likely to fail as they may result in increasing pressure on policy makers to soften the impact of the AAM or even abandon it altogether.
- Spain introduced the Revalorisation Pension Index (IRP) without wide political consensus in 2013.
- Mechanism indexing all pensions to account for the difference between the growth rate of total contributions and that of total expenditures, albeit with a minimum nominal indexation of 0.25% per year.
- Every year between 2014 and 2017, pensions were indexed at the floor of 0.25%, and, based on projections, the floor was likely to be persistently applied in the future given expected difficulties in financing public pensions in Spain.



Case study: Spain (3)

- Parliament deviated from this mechanism and instead indexed pensions to the CPI.
- In 2019, the IRP was suspended.
- Shows the need for political consensus.
- The introduction of an AAM leading to a steady decline in pensions in real terms during retirement is questionable as retirees have little possibility to adjust their income, for example by working more.



Case study: Spain (4)

- This also implies that corrective measures – through AAM or more generally – need to be implemented soon enough.
- Modifying pension calculations for current retirees is very difficult.
- Sustainability factor was supposed to take effect in 2019 but was suspended.
- Government reached a pension reform agreement with unions and employers in 2020.
- Established a new sustainability mechanism.



ERA OF HIGH INFLATION



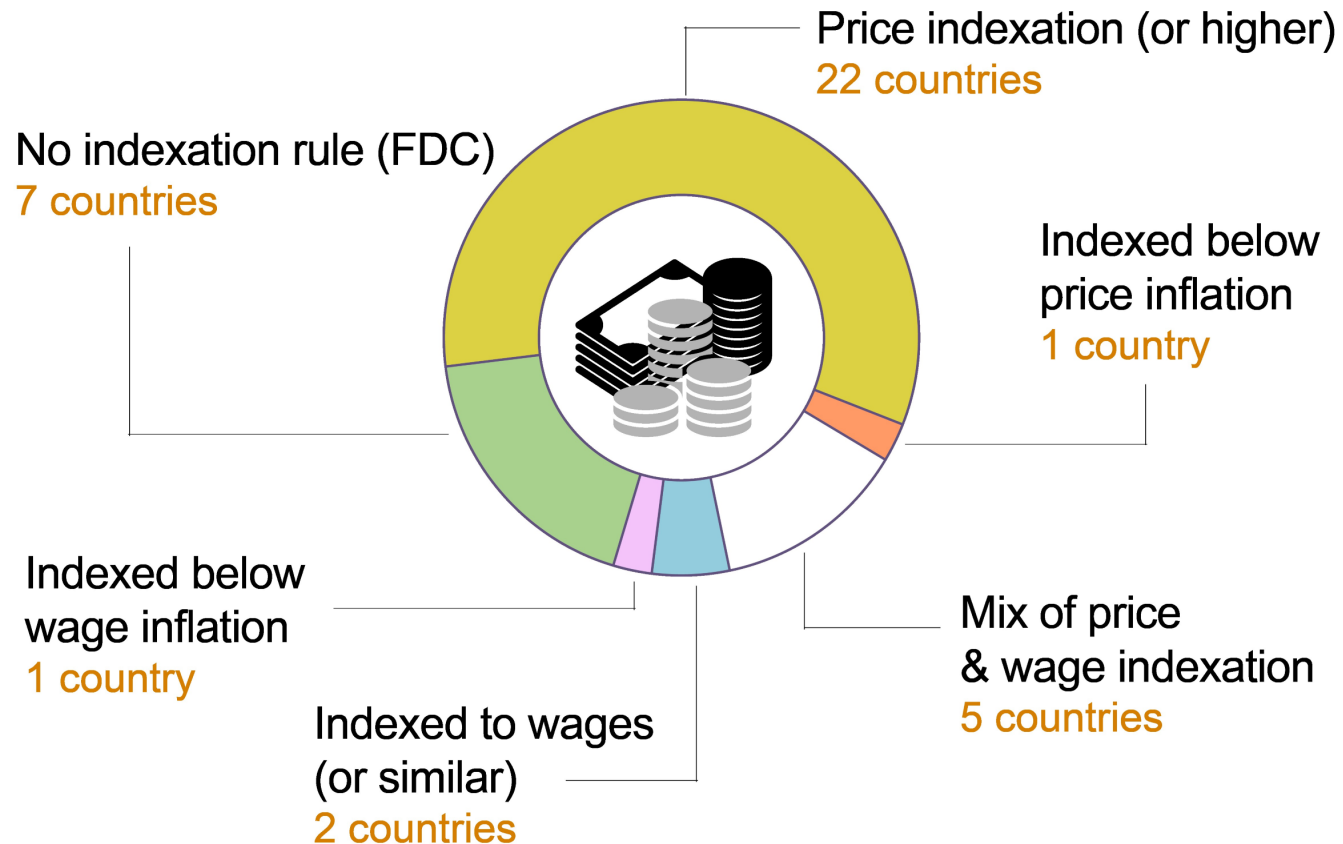
Key challenges of the last few years

- **Short-term challenge** : protect pensions against inflation
 - More than half of OECD countries fully protect pensions against inflation over time
- **Long-term challenge**: improve financial sustainability and protection for vulnerable groups
 - Substantial pension reforms over the last two years including: retirement-age increases; reforms to improve pension finances; benefit adjustments.



More than half of OECD countries fully protect pensions against inflation over time

Indexation of main earnings-related pensions to prices & wages



Good practice

- Belgium: fixed-frequency indexation

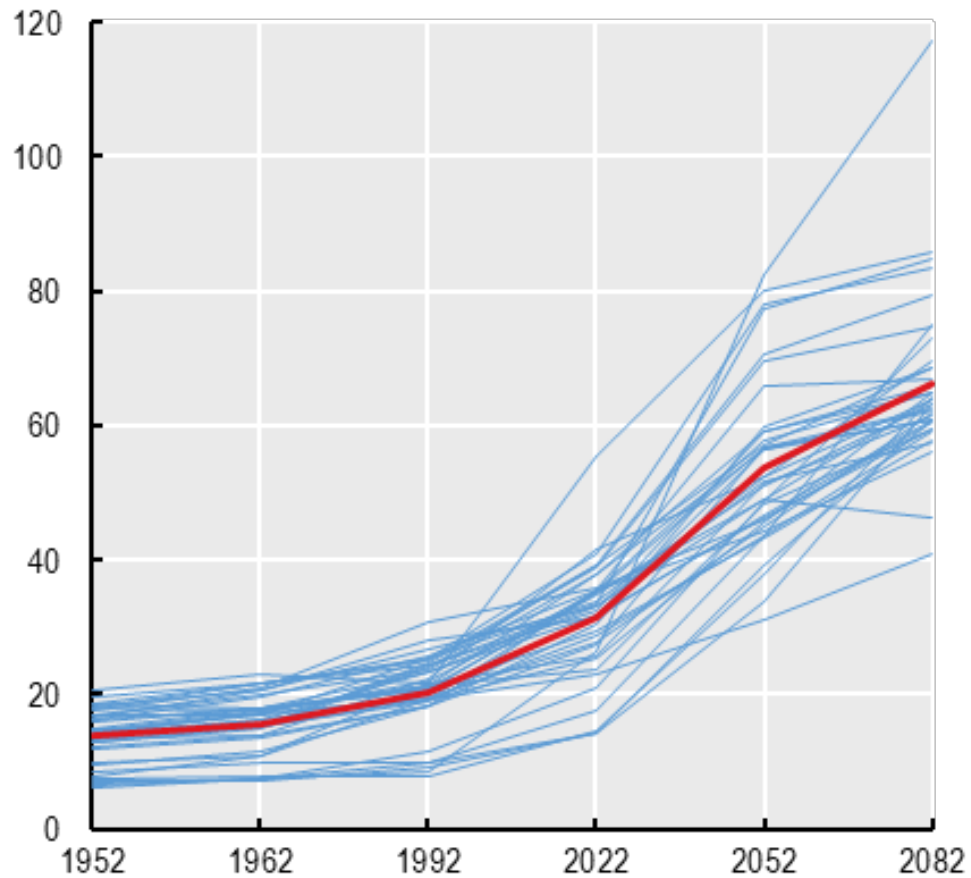
Recent reforms

- Improved protection against inflation:
 - Spain: reintroduction of price indexation
 - Latvia: higher frequency
 - Norway: from wages to mix
 - Slovak Republic: fixed-threshold indexation
- Improved pension finances:
 - Czechia: reduction of the wage component in index

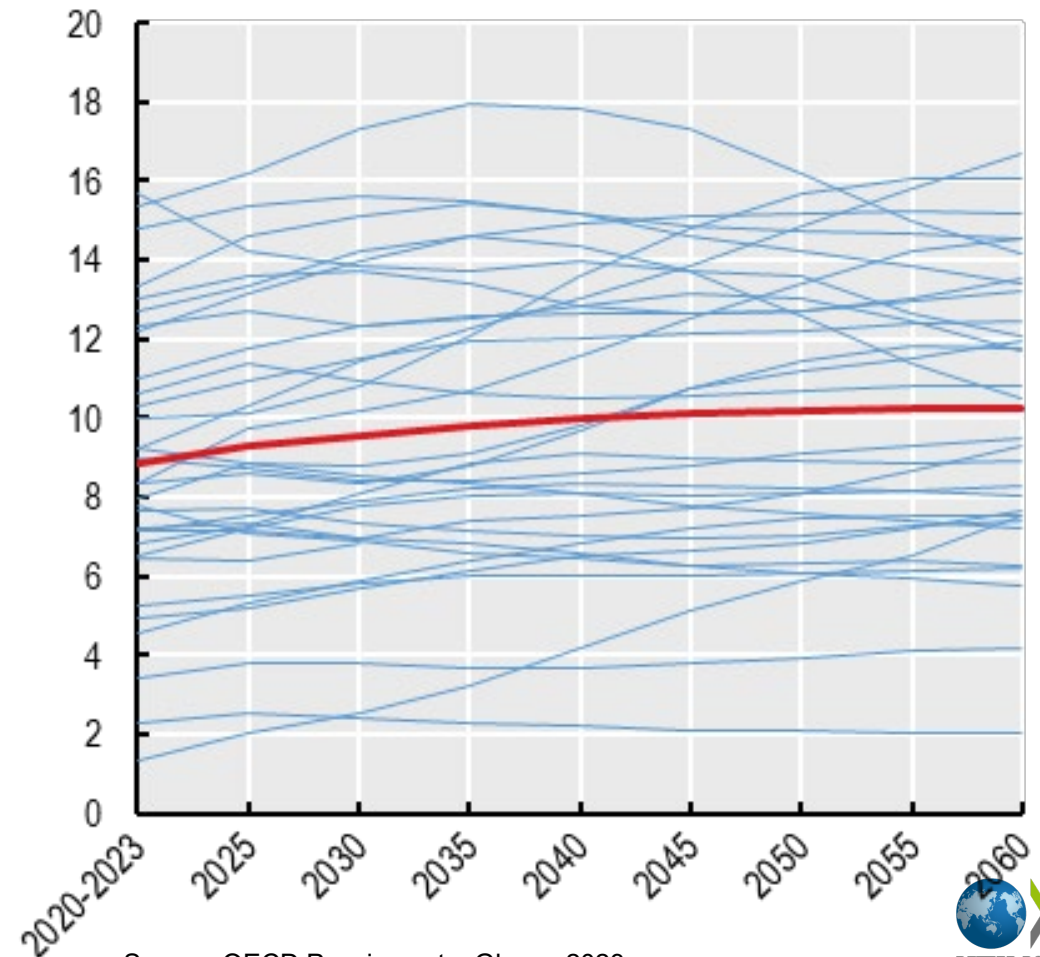


Past reforms limit spending increases despite steep ageing

Demographic old-age to working-age ratio



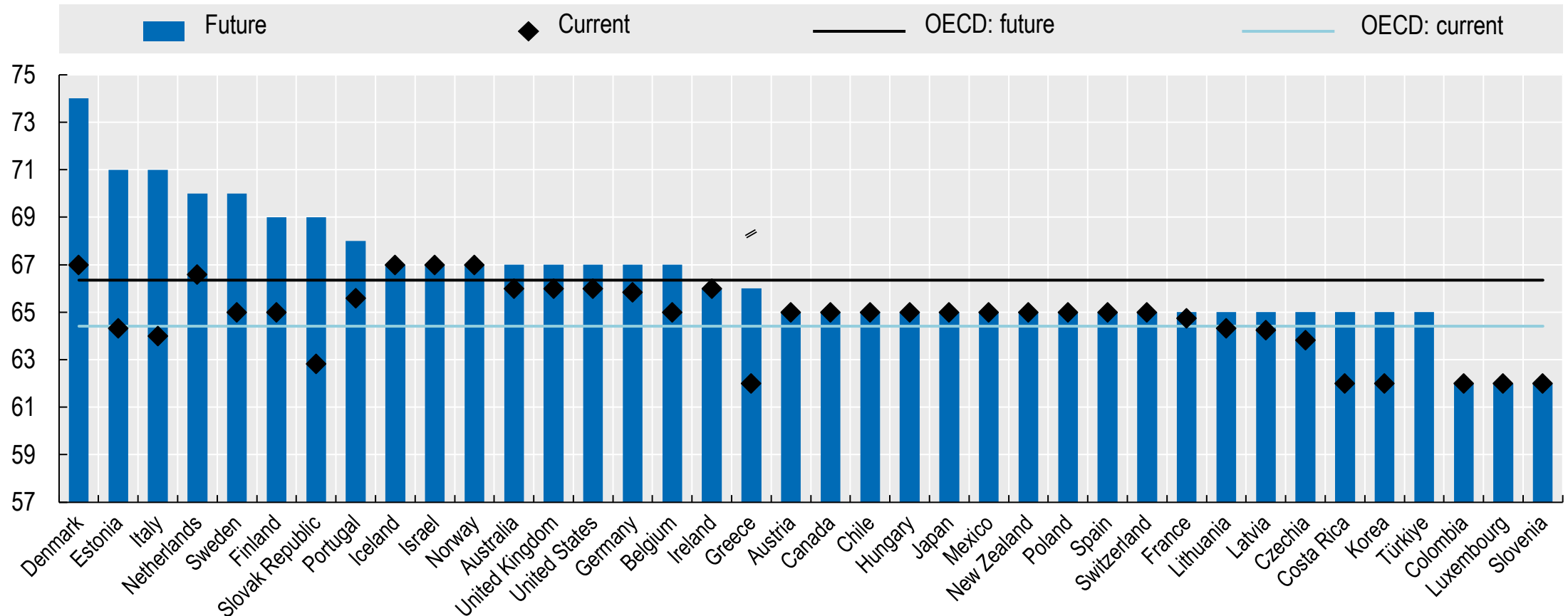
Public pension expenditure (% of GDP)





Average normal retirement age will go from 64.4 to 66.3 years

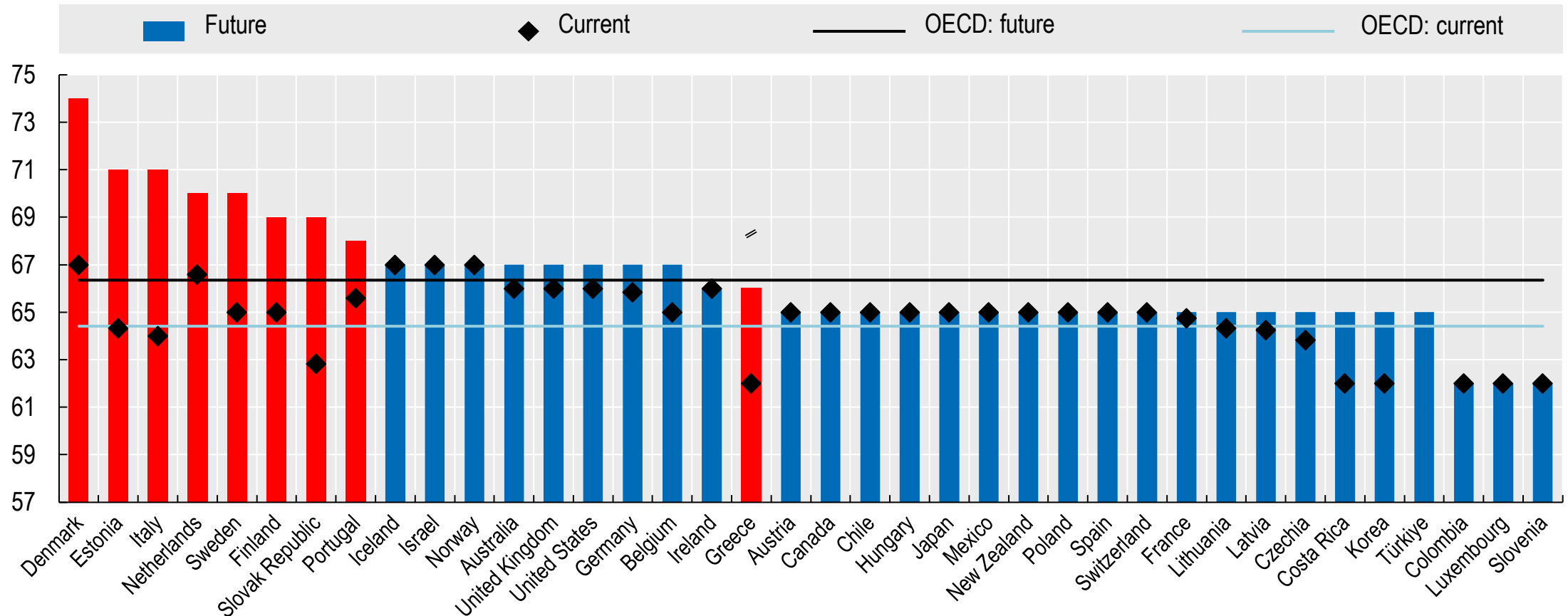
Normal retirement age for men entering the labour market at age 22 with a full career





Average normal retirement age will go from 64.4 to 66.3 years

Normal retirement age for men entering the labour market at age 22 with a full career





DB schemes under pressure

- Pension funds in the Netherlands will transition from defined benefit to defined contribution
- Spain increased contribution rates especially for high earners and reintroduced price indexation
 - Previously legislated automatic adjustment mechanisms were formally removed
- Costa Rica reduced effective accrual rates



Expansion of automatic enrolment

- 6 countries
 - Lithuania, New Zealand, Poland, Slovak Republic, Türkiye, United Kingdom
 - Ireland expected in 2024
- United Kingdom: expected to reduce minimum age from 22 to 18



Expansion of coverage to vulnerable workers

- Lower earnings thresholds reduced or eliminated
 - Australia: eliminated minimum earnings threshold for mandatory employer contributions
 - Costa Rica: halved minimum mandatory contributions
- Expansion of mandatory pensions to specific occupations
 - Chile: platform workers
 - Mexico: domestic workers
- Australia: easier procedure to pursue employers for unpaid contributions



CHANGING LABOUR FORCE



Key pension issues raised by the non-standard forms of work

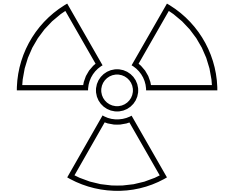
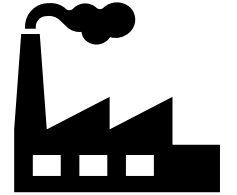
- Some **temporary contracts** and **part-time work** are **exempted from protection** in mandatory and voluntary schemes.
- **Self-employed** workers are not enjoying the same level of pension protection **as employees**.
- **Harmonising pension protection** between self-employed workers and employees is difficult due to lack of (distinct) employer and employment contract.
- **New forms of work** magnify challenges posed by “traditional” non-standard work on pensions: misclassification of employment status and informality.



Work, health, mortality and pensions

The context:

- Poorer health of workers in physically intensive jobs but this results also from other factors such as income, education and lifestyle.
- Life expectancy differs by occupations, but these differences relate largely to other socio-economic factors.
- Yet, some working conditions – e.g. working at night – negatively affect health, sometimes with some delay.

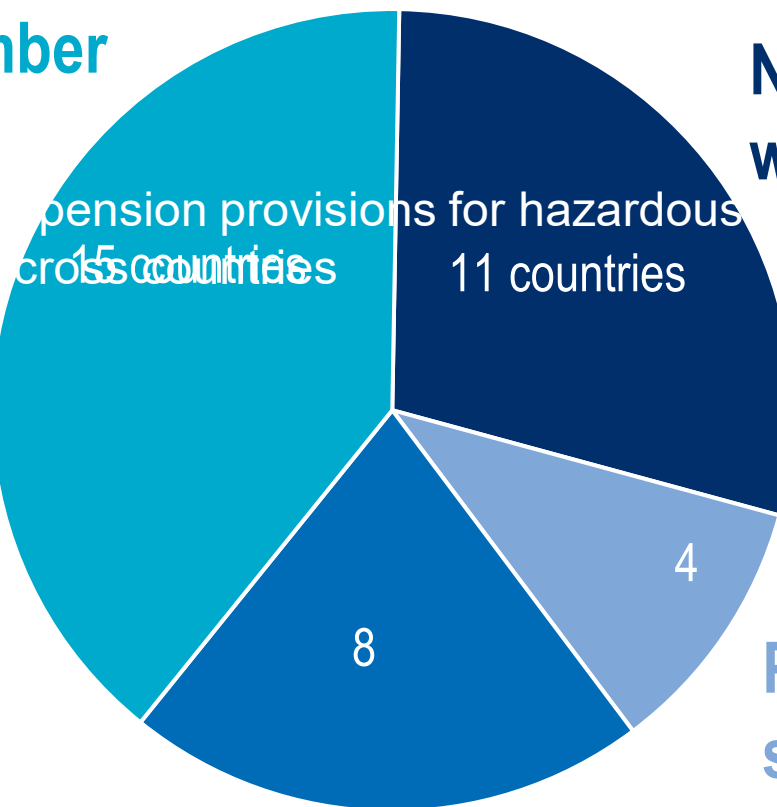




Special pension provisions for hazardous or arduous jobs differ across countries

Provisions for large number of occupations or jobs

AUT, BEL, CHL, COL, EST, FIN, FRA, GRC, ITA, NOR, POL, SVK, SVN, ESP, TUR



No special early retirement options within mandatory pensions

AUS, CRI, DNK, ISL, LTU, LUX, MEX, NLD, SWE, CHE, GBR

Provisions for limited number of jobs

CZE, HUN, DEU, JPN, KOR, LVA, NZL, PRT

Provisions for public safety and security jobs only (e.g. firefighters)

CAN, IRL, ISR, USA



Hazardousness or arduousness should be primarily addressed beyond pensions

- Hazardous or arduous work requires early and coordinated action of governments and employers.
- Working-age interventions:
 - Health and safety regulations to limit risks at work;
 - Informing about the inherent job-related risks;
 - Age-management policies, including lifelong learning and reskilling;
 - Long-term sickness and disability insurance to cover immediate health consequences of working conditions.



SINGAPORE



Positives

- High overall contribution rates
- Sustainable system as it is FDC
 - Individual accounts, so workers get back what they contributed
- Mandatory life annuities should help with adequacy
- Offers of up to 5-years reemployment after the retirement age



Possible issues

- Contributions are concentrated towards the ordinary account, particularly at younger ages.
- Earnings ceiling for contributions is relatively low compared to most OECD countries.
- Withdrawal from ordinary account severely lowers pension entitlements.
- Ceiling for the retirement account assets.



What can be done?

- Consider adjustment in balance of contributions being made to each account.
- Link retirement ages to increases in life expectancy.
- Remove ceiling for retirement account and tax pensions resulting from the larger balance.



CONCLUSIONS



Conclusions

- Pension systems are evolving.
- Risk is being moved from government to the individual.
- Political consensus is better for future reforms.
- Automatic adjustments are becoming more common.



THANK YOU

Access latest Pensions at a Glance report via:
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