

Regulating Private Pensions in Times of Crisis: Short-term and Long-term Consequences

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Abstract

Recent reforms led to retrenchment in state pensions and to a shift toward funded private pensions across Europe. The state partially retreated from public responsibility to finance adequate state pensions in order to make pay-as-you-go financed pensions sustainable in ageing societies. Due to the shift from non-funded to funded pensions and from defined benefit to defined contribution plans, retirees are faced with more uncertain pensions. Therefore, the need for state or collective regulation of private pensions increased. The recent financial crisis led to major losses among many pension funds across Europe, indicating the problems in shifting responsibility to private actors. Furthermore, the crisis highlights the problematic nature of funded private pensions that fall short of expected returns. Particularly those pension systems that are weakly regulated and where financial risks of funded pensions are shifted onto individuals demand attention. Indeed, the impact of the financial crisis on pension funds and future retirement income depends on the governance and regulation by state and non-state actors. However, there is a large cross-national variation in pension fund capitalism and its regulation across Europe.

Based on an international project on supplementary pensions in Europe, the paper reviews the governance modes of supplementary pensions, the scope for collective or state regulation, and the different modes of financing mechanisms. By studying Denmark, Germany, Great Britain, the Netherlands, Sweden, and Switzerland the paper compares the variety of supplementary pensions and analyzes their vulnerability to the financial crisis. It asks how different governance systems reacted to the crisis. Whereas higher contributions and suspensions of indexation may be temporary measures, more important are the long-term consequences for individuals, e.g. lower rates of return leading to lower pensions. There are multiple implications also for sponsoring firms, pension funds, the social partners and the state, in particular changing investment strategies and strengthening the supervisory mechanisms.

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1. Introduction²

For more than two decades, the financial sustainability of pay-as-you-go financed public pensions has been questioned and the privatization of prefunded supplementary pensions has been on the political agenda in Europe as the possible solution. The recent financial crisis has challenged the merits of private pension fund capitalism as many pension funds experienced substantial decline and trust in the expected returns has been shattered. The privatization of responsibility for old age income and the shift toward increased funded pensions raises major issues in respect to the governance and regulation of private pensions. We will investigate in our comparative analysis the role of collective and individual actors in regulating and governing private pensions. Although the state seems to retreat from former commitments to guarantee secure and adequate public pensions, the need for public regulation has increased - not diminished. In particular, we discuss the role of the social partners – employers and workers representatives – in regulating and governing such private pensions. Finally, we investigate whether and to what degree the beneficiaries of such arrangements – the current and future retirees – any participatory and social rights in the decisions concerning their occupational or personal pension plans.

Drawing on the experience of several countries with developed or growing multipillar systems (see Ebbinghaus 2011), we will discuss in this article six countries with different forms of supplementary pension systems and varying governance modes. We include Great Britain as a prime case of Anglo-Saxon Liberal Market Economy and advanced pension privatization but also look at two Coordinated Market Economies with rather exceptionally developed pension fund capitalism: the Netherlands and Switzerland. In addition, we analyze the growth of funded pensions in Scandinavian welfare states, taking Denmark and Sweden as examples. We also include Germany as a major case of Coordinated Market Economies with a still Bismarckian public pension tradition, albeit with increased reliance on private occupational or personal pensions.

In this article, we first discuss the conflicts of interests among stakeholders in private pensions, including vertical principal-agent and horizontal capital-labour relations. We then map the supplementary pension landscape for the six European countries under consideration. Thereafter, we analyse the importance of financial markets for occupational pensions and the dimension of

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pension fund capitalisms together with the inclusiveness of private pensions. The following sections discuss the stakeholders' participatory rights (especially the involvement of social partners) and the scope of state supervision. Next, we review investment regulations that limit the financial risks for beneficiaries. Before concluding, we discuss the short-term and long-term consequences of the financial market crises in the 2000s for both sponsors and beneficiaries.

2. The stakeholders in private pension governance

Conflicts of interests over supplementary pensions occur due to the complex *principal-agent* relations between beneficiary and sponsor, and between sponsor and financial agent. In the case of an occupational pension, employees rely on their employers who (co)sponsor the pension contribution, they also have to trust the pension funds that pool these resources and on financial managers investing on their behalf for their future pension (Besley and Prat, 2005: 121). As a consequence problems arise due to asymmetric information and 'hidden' knowledge on the side of the agent(s) vis-à-vis the principal (see McCarthy, 2006). Especially in the context of highly complex benefit calculations and investment decisions in volatile financial markets, the principals are incapable of fully controlling their agents who may engage in their own objectives. Moreover, supplementary pensions differ in the actors who decide on pension arrangements (the *initiators*), who stipulate the governance rules and control these schemes (the *overseers*), who pay into these supplementary schemes (the *sponsors*) and who eventually benefit from it (the *beneficiaries*). In the case of a firm's pension commitment to its employees, the employer may be initiator, overseer and sponsor, while in other cases some of these tasks are taken on by other actors, for instance, the social partners.

Given information asymmetries to the detriment of principals, trust plays a crucial role, but so does good governance and foresighted regulation. Further difficulties arise because agents can be principals at the same time or vice versa (Shapiro, 2005). Thus pension funds create *multi-level* principal-agent problems where the trustees are agents of the beneficiaries as well as principals vis-à-vis the managers of pension fund portfolios (Lakonishok et al., 1992). The European Union, the OECD and other international organizations have suggested a range of institutional arrangements and instruments to reduce the risk of mismanagement and fraud by the agents: supervisory

agencies, whistle-blowing procedures, code of good practice, dissemination of ‘best practice’ models and information rights.³

In our subsequent analysis (see also Ebbinghaus and Wiß, 2011), we distinguish three *governance* modes of supplementary pensions based on the sponsor and beneficiary: the individual decision to personal pension, the employer-sponsored occupational pensions, and the collective pensions decided by the social partners (see Table 1). Economic theory assumes the importance of ‘exit’ as a market force, while we will focus here more on the ‘voice’ mechanism: the participatory rights and regulatory rules in favour of current and future beneficiaries. Institutional complementarities between corporate governance traditions and pension fund governance can be expected since principal-agent relations between investors and investment funds are embedded in more or less contentious labour relations – either the relationship between employer (sponsor) and employees as well as retirees (beneficiaries) or between employer associations and trade unions (the initiators and overseers). This adds an additional *horizontal* ‘class’ conflict: the negotiations between employers and employees on occupational benefits as part of the individual employment contracts or as part of the collective bargaining on (social) wages. Labour relations may vary in the degree to which they are contentious or consensual, centralized or decentralized (Ebbinghaus, 2006); this will have major repercussions on private pension governance.

Table 1 Collective, employer-led and personal supplementary pensions

Collective occupational Pension	Employer-led occupational pension	Personal pension
<p style="text-align: center;"><i>Sector-wide:</i> <u>Netherlands, Denmark,</u> <u>Sweden, Switzerland,</u> Germany</p>	<p style="text-align: center;"><i>Pension fund:</i> Netherlands, Switzerland, <u>Germany</u> (also book reserve), <i>Opt-out:</i> Britain: <u>pension fund trusts</u></p>	<p style="text-align: center;"><i>Mandatory public pension:</i> Swedish Premium P., Danish Special Savings P., <i>Voluntary:</i> Germany (Riester), <i>Opt-out:</i> Britain (Personal, Stakeholder)</p>

Note: Main systems underlined.

In the case of *collective schemes* employer and unions agree on jointly managed pension schemes, usually external to the firm and for several firms. These agreements usually allow for broader coverage and risk pooling, while limiting the voice of stakeholders (sponsors and beneficiaries) to indirect representation through employer associations and trade unions or workplace representatives. The main advantages are the better information capacity and economies of scale of

³ See also OECD and EU reports on private pensions (OECD, 2001; OECD, 2002; OECD, 2004; OECD, 2005; SPC, 2005).

collective schemes in comparison to a single employer, particularly a small firm without professional financial experts, or an individual, particularly one without adequate financial knowledge. Collective schemes provide better portfolio management and lower administrative costs than single-employer or individual schemes (Trampusch, 2009). Nation-wide or sector-wide schemes also allow workers to move between firms without loss of, or disadvantages in, former benefits. In employer-sponsored schemes, these can be at risk when an employee moves to another company, depending on vesting rights. Collective schemes, self-administered by the social partners assume an important second tier function in Denmark, the Netherlands, and Switzerland, while negotiated occupational pensions are also nation-wide ‘top-up’ benefits in Sweden and are gaining in importance in some sectors in Germany. However, the decentralized labour relations and lacking state intervention in Britain prevented the evolution towards sector- or nation-wide schemes.

In the second governance mode – *employer-sponsored* pension plans – firms might be willing to provide defined-benefit (DB) pensions for human resource strategies by binding qualified workers (Lazear 1990). These pensions could be financed by book-reserves (directly by the firm), by a trust fund independent of the firm, or a contract with an insurance company. Employers as sponsors mainly control these plans, while the employees as future beneficiaries have often only indirectly a voice through the trustees picked by the sponsor. These firm-sponsored occupational schemes (whether pension funds or book reserves) may have higher administrative costs for the firm than collective plans, yet the employer can use these plans for human resource management strategies in order to bind employees to the firm, which would not be the case in collective plans that provide similar benefits across firms. Depending on corporate governance regulation and practice, employees and their representatives may have only limited rights and influence on employer-sponsored plans. Employer-sponsored occupational pensions that contract out of the second state pension play an important role in Britain. Employer-specific occupational pensions are also a preferred form for Dutch and Swiss larger firms, and German firms provide these as voluntary fringe benefits.

In the case of *individual decisions*, there might be a collective action problem of individuals that have not much power (‘voice’) vis-à-vis the investment fund manager, as they might only be able to vote with their feet (‘exit’) by switching to a different fund. Here the responsibility remains solely with the individual, though the state as regulator sets the legal framework and standards, particularly through tax codes and rules for subsidies. An advantage of personal pensions that are commonly defined contribution (DC) scheme is their portability. Besides the two mandatory personal pensions in Denmark and Sweden, voluntary personal pensions are particularly common in Germany thanks to tax subsidies (since 2001) and in Britain since an opt-out option was granted (in 1986).

3. The different worlds of supplementary pensions

There are different worlds of supplementary pension systems, varying from mature multipillar systems to those where occupational and personal pensions play a rather limited role. Among the more mature multipillar cases, Great Britain has a long tradition of pension fund ‘trusts’. Employers can decide to contract-out from contributions to the mandatory state second pension since 1978. Since 1986 also individuals could opt out by choosing a personal pension. However, recent pension acts (2007/08) limit the possibility in the future to contract out DC plans, and require employers to provide access to a supplementary pension by 2012 (auto-enrolment). In the Netherlands, occupational pensions are mainly sector-wide schemes that are negotiated by the social partners and can be made mandatory by the ministry, and there are also some larger company pension funds. In Switzerland, occupational pensions are mandatory since 1985 but take on different forms: the joint foundations are administered by the social partners for a sector, in group (multi-firm) foundations conditions vary across firms, and single firm plans also exist.

Among the intermediate group in pension privatization, the Scandinavian countries, Denmark has been a laggard until the ‘labour market pensions’ developed as sector-wide collective agreements since the 1990s (similar schemes already existed in the public sector) and a mandatory personal pension (suspended since 2004). In Sweden, there are mainly four nation-wide negotiated supplementary occupational schemes, two for public employees and two for private employees that provide a ‘top up’ benefit. Following the 1994/98 reform, a funded DC personal pension is part of mandatory public pension contributions, but individuals have the choice of their investment portfolio (including union-run schemes). Finally, Germany remains less developed but occupational and personal pensions have become more important in recent years, while public pensions are cut back. Depending on the model used, German employers are more or less solely responsible for the administration in the case of the ‘on-the-books-reserves’ and support funds. Large German companies have their own occupational schemes, although employers are typically bound to sector-wide collective agreements. Within this frame they can chose between several modes of occupational pensions regulated since 1972. The 2001 reform introduced voluntary personal pensions, leaving individuals to decide whether or not to sign a state-regulated *Riester* contract (subsidized for low income groups).

4. The varieties of pension fund capitalism

Private pensions are considered to foster financial market capitalism through the investment of pension funds and personal saving plans. Whether pensions are funded through investments in

shares, bonds or other financial instruments have major implications for the political economy. Pension investment, in particular by larger pension funds can provide a major impact on financial markets and corporate governance nationally and internationally. Today's level of pension fund assets indicates the importance of funded supplementary pensions for the later old-age income among the elderly but also for their importance on financial markets. Based on the Varieties of Capitalism approach (Hall and Soskice, 2001) we can assume that there is a relationship between the importance of financial markets in Liberal Market Economies (LME) and a reliance on private funded pensions, while in Coordinated Market Economies (CME) we expect more reliance on PAYG occupational pensions in the public sector and on unfunded 'book reserves' of private sector firms (Jackson and Vitols, 2001).

The variations in pension fund assets, financing vehicles and asset allocation reflect the differences in the design and maturity of funded pensions, including pension funds, personal DC pensions, and public reserve funds (see Table 2). The potential impact of pension systems on financial markets is very high for the British LME due to the funded occupational and personal pensions that are allowed to contract-out of the (unfunded) state second pension. Also according to expectation, pension fund capitalism in a CME is still relatively low in Germany, although pension assets are growing with average annual growth rates around 15 per cent. However, Switzerland and the Netherlands, both considered to be CME, rank also high in funded capitalism, channelling substantial investments through the Dutch collectively negotiated and the Swiss mandatory pension funds. Moreover, the Nordic CMEs (Denmark and Sweden) have by now also substantial pension fund capitalism, both as part of the public and private pensions.

The scope of pension fund capitalism is measured in the investment of supplementary pensions, thus it is central whether or not pensions are fully funded or not. In *funded* systems contributions are invested in capital markets, expecting higher returns. However, in DB pension funds, the employers is mainly responsible to provide for underfunding of pension liabilities, while they may profit from contribution 'holidays' in times of overfunding. In funded DC schemes administrative costs and financial charges for investments are higher, while the financial market risks are completely individualized. All occupational pension plans are funded in Switzerland and the Netherlands. In the United Kingdom, Sweden and Denmark all plans in the private sector are funded. The same holds for most of the new German private sector occupational pensions (but still with high book reserves liabilities).

Table 2 Pension fund capitalism, Europe 2001-2008

	Funds	Funds &c	Financial assets		Contributions	Benefits
	% GDP	% GDP	millions US Dollar		% GDP	% GDP
	(a) 2008	(b) 2007	(a) 2008	2001-08	2008	2008
Netherlands	113.2	(149.1)	988.1	+13.4%	4.0	3.7
Switzerland	99.3	(151.9)	496.6	+9.6%	8.7	5.4
Britain	61.8	(96.4)	1 644.8	+6.8%	2.8	2.8
Denmark ^a	47.4	(140.6)	161.7	+20.6%	0.5	0.6
Sweden	39.1 ^b	(57.4)	35.3	+9.9%	-	-
Germany	4.7	(17.9)	172.4	+14.9%	0.3	0.2

Notes: (a) Funds: private pension fund investments (% GDP); (b) Funds &c: total private pensions, including also insurances and book reserves (% GDP);

^a the increase in 2008 is due to semi-public funds that experienced a strong increase in the value of bonds and other assets; ^b: including funded public pensions (Swedish Premium Pension) and public pension reserve funds (Sweden: 31.7);

Germany: only Pensionsfonds and Pensionskassen (no book reserves); Denmark: including public second pension.

Source: OECD (2009a; 2009b).

Some public sector occupational pensions are PAYG systems, that is, current contributions are rechanneled to pay benefits of current pensioners. In so far they face the same demographic and sustainability problems as public pensions, thus the state (including public sector companies) have to guarantee long-term sustainability. PAYG schemes are still common in Denmark, Germany, Great Britain and Sweden. Nevertheless, increasingly reserve funds are devised or new entrants are insured by partly funded schemes. Similar problems occur with the book reserves, many larger German private firms profited in the past from credits provided by banks and on the book reserves of their occupational pensions (Jackson and Vitols, 2001; Vitols, 2003). With increased importance of shareholder value, a reorientation from DB schemes (often with book reserves) towards funded DC schemes occurred. However, these recent changes will not increase assets rapidly due to the often lower contributions and more limited take-up rates (Davis, 2003). Moreover, the public sector's occupational scheme is still PAYG in West Germany.

5. The inclusiveness of private pension regulation

The importance of supplementary pensions partly depends on coverage, in particular the share of employees with access to private pensions. Membership in private occupational or personal pensions is largely determined by who decides on supplementary pensions: the state through a mandate, the social partners via collective agreements, the employer by voluntary commitments or the individual by choosing a personal savings plan. While mandatory membership by law includes all employees, coverage can be also extensive where collective bargaining is relatively

widespread due to high union density (Scandinavia), relatively encompassing employer organizations (Germany) or state-extended collective agreements (the Netherlands). Mandatory pensions enforced by law or quasi-mandatory collective schemes negotiated by the social partners make private pensions more like public pensions by providing broader coverage, often also applying stricter regulation, pooling risks more equitably, using economies of scale, and more professional advice. Wider coverage also reduces social selectivity as well as the moral hazard selection problem, that is, those that are most difficult to cover are excluded by insurers.

Membership in voluntary firm plans is often more concentrated in large firms, which rely on internal labour markets and provide occupational pensions as fringe benefits to bind employees. In most occupational pensions, the individual is not responsible for investments; though in some cases personal choice is possible. In contrast, when the individual alone is responsible whether or not to sign a supplementary personal pension plan, the awareness of a possible pension income gap and the necessary financial knowledge may vary considerably as does the individuals' capability to save, thus creating significant inequalities.

There are considerable differences in employees' coverage that result from state intervention and the scope for collective bargaining (see Table 3). The most widespread schemes cover more than 70 per cent of employees due to mandatory state intervention in Switzerland (since 1985), widespread intervention of the Ministry in extending collective agreements in the Netherlands (since 1949), and, strong unions that lead to broad coverage of collectively negotiated schemes in Denmark (since 1990s) and Sweden (since 1970s). A more intermediary group (see Ebbinghaus and Wiß 2011), Britain and Germany, covers a substantial workforce share (above 50% but below 70%).

Apart from state mandated occupational pensions in Switzerland negotiated collective pensions can also assume a quasi-mandatory role. This is the case in the Netherlands and the two Scandinavian countries. The Dutch Labour Minister can declare sector-wide agreements as compulsory for all employees in the respective sector on request of employer and employee representatives, this holds for about two-thirds of sector-wide funds (OECD, 2008: 267). In Denmark sector-wide occupational pensions spread after the first important private sector agreement in 1991, though public sector employees had already their own schemes by then. In Denmark and Sweden these plans are compulsory for all employers and employees covered by the agreement. Unique for European countries are the mandatory personal pensions: Danish individual pensions ('Special Savings Pensions' for employees and self-employed) and the Swedish Premium Pension (allowing individual investment choice of a part of public pension contributions).

Table 3 Coverage of occupational and personal pensions (% employees)

	Occupational pensions	Personal pensions
<i>Mandatory</i>	<i>Mandatory (>90%):</i> Switzerland (1985)	<i>Mandatory public pensions:</i> Denmark (1991: SP*) 89% Sweden (1999: SP*) 100%
<i>Opt-out</i>	Britain (1978) 47%	Britain (1986) 19%
<i>Voluntary</i>	<i>Collective agreements</i> Netherlands (1949) >90%** Sweden (1976) >90% Denmark (1991-) 76% Germany: public sector (1969-) 20%, private sector >50%***	Germany (<i>Riester plan</i> 2001): 44%

Notes: *SP: personal state pension (Sweden: Premium Pension, Denmark: Special Savings Pension);

** erga omnes extension by Ministry possible; *** Germany 2001: legal claim and precedence of collective agreements.

Source: Ebbinghaus and Wiß 2011; OECD 2009: 141.

In contrast, occupational pension coverage ranks at medium level for the second group of countries: Germany and Britain. Generally, all German employees have the legal claim to postulate an earnings-conversion since 2002, with some limitations due to existing collective agreements. In contrast to the private sector, occupational pensions for non-tenured public sector employees are regulated by collective agreement (already since 1969) with advantageous conditions. The funded individual pension (*Riester* plan) was not made compulsory in 2001; instead high state subsidies were devised to promote coverage among low earners, leading after some initial reluctance to a take-up rate of more than 44 per cent in 2008. Britain also has a relatively high-medium coverage-rate thanks to the ‘opt-out’ option for occupational pensions (47%) and personal pensions (19%). This option is possible for employers providing an occupational pension (1978) and for individuals signing a personal DC pension plan (1986). Given the low flat-rate basic pension and the opt-out option, the niche left to non-state pensions was largest in Britain compared to all other non-mandatory private pension systems but widespread coverage failed.

6. Private pension governance and stakeholders’ participatory rights

The participatory rights of employees and beneficiaries but also the way in which the principal-agent problem applies can vary substantially, depending on the governance form of supplementary pensions. On the one hand, pension schemes that are *internally* organized such as public sector (PAYG) schemes and employer commitments (book reserves) depend on the trust in the financial sustainability of current and promised future benefits. On the other hand, the

pension contributions may be invested by the principal (sponsor) in an *external* independent fund (agent) which is sheltered from the risk of bankruptcy by the sponsoring firm.

Pension schemes with internal governance are those public sector schemes with PAYG-financing and those employer commitments that are directly financed from a company's balance sheet (book reserves). Public sector schemes in Denmark, Germany, Great Britain and Switzerland are, at least partly, PAYG organized as the state takes on responsibility for their sustainability.

In the case of book reserves, commercial firms are paying current pensioners, while future liabilities (usually for defined benefit pensions) are funded through future returns on reinvestment into the company. In terms of liabilities, direct employer commitments are still the most important occupational pension form in Germany, and are thus governed by the company management. In case of codetermination of listed companies, a supervisory board with bipartite labour-employer representatives oversees the company, but otherwise only weak rights for works councils exist in respect to occupational pensions. The Swedish occupational scheme for private employees also uses book reserves (closed since 2007); employers have to register with the Pension Registration Institute, administered by social partners who then manage benefit and pay out pensions.

Most occupational pensions, however, are sponsored by employers and organized externally. This means that pension funds are independent of company balance sheets and shielded from the risk of bankruptcy. In many countries it is possible for employers to participate in multi-firm or open pension funds. In addition, employers, particularly small firms, might choose to pay into life or group insurances, even though they have higher administrative costs per insured. In the case of pension funds set up by employers, the administration and supervision is decided by the sponsor according to trust law, whereas in the case of insurance contracts the administration and supervision is outsourced, hence the sponsor and beneficiary need to rely on public supervision and regulation of financial agencies to be ensured of their rights.

External employer-led pension funds dominate in the mature British multipillar system. The Board of Directors of British companies are not legally required to have any employee representatives, and pension funds are overseen by trustees appointed by the sponsor (firm). However, by law the trustee must govern on behalf of the interests of the beneficiaries, and one third of trustees must be member-nominated (employees and retired beneficiaries) and there is pressure to increase the share of member-nominated trustee seats. Pension funds are also increasingly common in German larger firms instead of book reserves following the externalization of liabilities.

Collectively negotiated pension schemes with joint administration balance interests between sponsors and beneficiaries more equally. Such schemes exist in nearly all multipillar systems, except

Great Britain. It is very common in the Netherlands and Switzerland, but also in Denmark and Sweden. All Dutch pension funds are managed by a bipartite governing board. In this model employees as well as pensioners can be represented, and on request an advisory board has to be established which holds decision-making power for contributions and benefits. Mandatory Swiss occupational pensions are strictly regulated. Almost all pension institutions take the form of corporate (firm-based), group (multi-firm based) or joint foundations (sector-wide). By law these are supervised by bipartite committees but in smaller companies representative rights are not always taken up. Assets are either administered by the bipartite committee or contracted out to financial institutions, though the bipartite committee remains responsible for investment guidelines. In Danish pension funds half of the board that governs the pension fund must be elected by and chosen from the plan members, and in most pension funds' administration representatives of unions dominate (Green-Pedersen, 2007: 468). New schemes in Germany have emerged since the 1990s. In Germany superannuation funds and pension funds must follow the two-tier executive board and bipartite supervisory board structure, while collective pensions schemes (e.g. *Metallrente*) are administered jointly by the social partners.

Pension funds as institutional investors can use their voice as shareholders to influence management. For instance, Danish pension fund administrators have been criticising companies for insufficient profits, bad management and insufficient information. Especially collective pension funds, which are administered equally by employers and unions, can exert pressure on firms and promoting social, employment and environmental standards (see for literature: Clark and Hebb, 2004: 144). In addition, new 'ecological' or 'social' pension funds might be established in the future for social and environmental oriented consumers (already present in the field of banks).

Further external modes of governance are group or individual insurance contracts underwritten by the employer. The personal pension in Great Britain (including contracting-out option) provides thus far the choice of private pension companies but no further influence for beneficiaries. Direct insurances are common for German small and medium-sized companies due to higher costs of setting up pension funds.

In Denmark, two-thirds of the sector-wide pension plans are contracts with life insurance companies, though a bipartite board of directors governs the pension institution, which administers contributions and benefits. The mandatory Special Pensions Savings are administered by a bipartite fund, but the individual is able to choose their own fund manager and portfolio. The Swedish pension foundations for white-collar private sector have a governing board with an equal number of employers and employees representatives. In the case of insurance plans special institutions administered by social partners act as intermediaries. A public authority administers the mandatory

Premium Pension but individuals can choose in which mutual funds they invest their mandatory contributions.

In sum, in the Dutch and Swiss mature multipillar systems there is a strong tendency toward bipartite collective schemes with pension funds independent of firms, while in Britain occupational pension funds provide more limited and the personal pensions no participatory rights. In the Scandinavian countries supplementary pensions are increasingly implemented through insurance contracts with parity supervision. In addition, public personal pensions were made mandatory in Sweden and Denmark, allowing the individual choice of financing institutions. Germany still has a tradition of mainly internal occupational pensions (PAYG and book reserves) but there are signs of growing importance of collective agreements and external independent pension institutions (pension funds and insurance contracts).

7. The role of the state in supervising pension funds

In addition to regulation and governance (by social partners), supervision is crucial for protecting beneficiaries from non-prudent investment strategies by agents. More effective supervision is possible in the case of collective schemes in Continental Europe than for single-employer pension funds in Britain (Laboul and Yermo, 2006: 517), though much depends on additional state regulation. Particularly the Dutch quasi-mandatory and Swiss mandatory schemes have substantial supervision, while Britain exercises more restraint. The Dutch Central Bank supervises occupational pension funds (besides other financial institutes). The Swiss occupational pension schemes are supervised by cantonal and federal supervisory authorities: the Federal agency examines the compliance with federal law and undertakes necessary preventive measures against insufficient funding. Although British pension funds are regulated at arm's-length, following the Maxwell pension fund scandal, regulation has been tightened since 1995. The British private schemes are certificated after passing reference scheme tests for DB and protected rights tests for DC schemes (including personal pensions), while the Pension Regulator is responsible for the supervision of occupational pensions.

The Scandinavian countries have encompassing supervision for both quasi-public and private supplementary pensions. Danish occupational pension funds and insurances must be registered and are supervised by the Danish Financial Supervisory Authority that describes detailed rules, including annual reporting by an approved actuary. The mandatory labour market pension fund (controlled by social partners) administers a part of the personal pension since individuals are free to invest their contributions via financial institutes since 2005 (Green-Pedersen, 2007: 468). The Swedish

Financial Supervisory Authority supervises all financial institutions, while the new pension authority administers and manages the social insurances and the Premium Pension.

In Bismarckian systems, public pensions have often been self-administered and supervised by bipartite boards (Ebbinghaus, 2010), while private pension institutions are supervised by supervision authorities common for the financial sector. In Germany, the Federal Financial Supervisory Authority supervises banks, insurances, and pension funds. Led by a board with state and fund representatives, it controls the solvency, transparency, consumer protection and certification (Riester-pensions) of private pensions. Additionally, European Union directives prescribe a supervision framework for pension institutions and supervisory institutions. The payment of outstanding claims to employees in the event of their employers' insolvency should be guaranteed in line with directive 80/897/EEC. In sum, in most of the countries state institutions exist that are responsible for the supervision of pension provider companies. They might request information, are responsible for stress tests and they are entitled to carry out on-site inspections. The main thrust behind these regulations is to ensure their financial sustainability and guarantee the underwritten liabilities, thus they are mainly concerned with financial sustainability not social adequacy of private pensions.

8. Controlling investment strategies for the benefit of pensioners?

Fundamental problems for funded pension schemes are financial market downturns of the severity experienced at the beginning of the millennium and more recently in 2008/09. In DC schemes, downturns might cause substantial reductions of an individual's pension, while in DB schemes it will lead to underfunding and increase liabilities for the sponsor (employer or collective fund). The low and partly negative rates of return after 2001 and again in 2008 point to this fact. The Dutch pension funds lost 11.9 per cent in 2002 and again it dropped by 16.9 per cent in 2008, while Great Britain (17.4%) had even worse declines in real returns during 2008 (OECD, 2009). Such a downturn may lead to severe underfunding of future pension liabilities and problems to guarantee minimum rates of return, depending on the statutory rules. For instance, Swiss pension institutions lobbied with success for a lower statutory minimum rate, given the financial market downturn in 2000/01, but the earlier high rates of return had been often used for lowering contributions of employers and not for savings during better years. Similarly, in the Netherlands the 1990s surpluses were used to premium rebates, while the pension funds became severely underfunded during the subsequent financial market downturns. Regulation is appropriate in order to promote benefit security and to boost the national and

European financial markets. Funded pensions institutions are subject to investment restrictions like rules on currency matching, allocation of assets and investments in the sponsoring company (EU Directive 2003/41).⁴ In the field of life insurances several EU directives include amongst others investment rules and criterions about guarantee funds in the event of insurance companies' insolvency (SPC, 2005: 33).

A prudent management can reduce the risk by shifting assets of people nearing retirement into less volatile investments (SPC, 2005: 22f). But additional quantitative restrictions that balance portfolios with risky equities and more secure bonds are needed as well as minimum rates of return to protect individuals from undue financial risks. A convergence toward the less determined 'prudent person' rule in investment regulations and less quantitative restrictions (Laboul and Yermo, 2006: 508) which would allow more investment flexibility and higher rates of return (Davis, 2003: 126), but with higher risks, does not seem to be prevalent, even if countries like Britain and the Netherlands apply such rules.

Strict state restrictions for investments exist in some cases: Swiss pension funds had only a 12.5 per cent decline in returns and German funded schemes 8.5 per cent in 2008 (OECD, 2009). Swiss mandatory funded schemes invest in different regions and economic sectors, minimum interest rate was 2 per cent in 2008 (compared to 4% in 2002), there is a maximum of 30 per cent in foreign currencies or bonds as well as foreign equities, and a maximum of 50 per cent may be equities and only 5 per cent in the sponsoring firm (OECD, 2008: 432). In Germany, restrictions for direct insurances and superannuation funds are a maximum of 50 per cent in bonds, 35 per cent in investment funds, 10 per cent in shares of non-EU companies and a maximum of 5 per cent in hedge funds. There are almost no quantitative constraints for pension funds, though a maximum investment of 5 per cent of the assets in the sponsoring firm (OECD, 2008: 227). The minimum interest rate for Riester plans based on insurance contracts is 2.25 per cent p.a., while the accumulated contributions are guaranteed by the financial service provider.

Less strict rules of investments exist in Denmark: at least 30 per cent of assets must invest in low-risk investments, and a maximum of 70 per cent may be placed in equities, though only 10 per cent in shares issued outside the OECD (OECD, 2008: 221). All Danish pension institutions offer a minimum rate of return. Thus Great Britain, the Netherlands and Sweden have the lowest investment regulation in line with the self-governing 'prudent person' rule. In the Netherlands and Britain the lowest investment regulation (with higher investment risks) comes along with funded-

⁴ See for the genesis of IORP Directive including discussion: Haverland (2007); for its limited application Guardiancich and Natali (2009).

only occupational schemes (with exception of the British public sector). In fact, in both countries the dangers of financial market crises are highest.

Table 4 Pension fund portfolio allocation (in % of investments) 2007/2008

	Cash	Bonds	Loans	Equities	Buildings	Private funds	Other investments
Britain (2007) ^a	3.7	27.1	1.2	45.8	2.8	–	19.4
Denmark (2007)	0.8	57.2	1.5	14.6	1.2	–	24.8
Germany (2008)	5.3	38.3	29.3	6.1	2.4	1.0	18.6
Netherlands (2008)	4.8	37.5	3.7	37.3	2.7	–	14.1
Sweden (2007)	2.2	53.6	0.0	36.5	3.4	–	4.2
Switzerland (2007)	9.1	38.9	4.6	32.7	9.4	4.5	0.7

Notes: ^a (Great) Britain: Equity share holdings are at market value and all other holdings at book value. Private equity and venture capital are included in equity. ‘Other investments’ 9.5% unallocated insurance funds, and the rest include security repurchase agreements, commercial paper and contributions receivable.

Source: OECD Global Pension Statistics.

9. Short-term and long-term consequences of the financial crisis

The recent financial market crisis led to major losses among many pension funds across Europe. Funded pension systems in OECD countries lost \$5.4 trillion with an average reduction of assets’ value of 20-25 per cent (Eureport, 2010(1-2): 24). In contrast, in 2009 almost all countries had positive rates of return but from a much lower starting point (e.g. 15% of the losses in 2008 are larger than 15% of the gains in 2009). These sudden losses affect employers as sponsors in the case of DB schemes as well as future and particularly current pensioners depending on DB and DC schemes. The crisis highlights the problems of shifting responsibility to private actors without proper regulation and the problematic nature of funded private pensions that fall short of expected returns. Even if pension funds are partly recovering since 2008, the effects of the crisis are still present, undermining the expected long-term growth of but also the trust in funded pensions. Particularly those pension systems that are weakly regulated and where financial risks of funded pensions are shifted onto individuals (DC schemes) demand attention. In addition to the state, the social partners can function as mediators to solve the consequences and face the reactions of firms and pension funds. Via collective bargaining and involvement in the operation and management processes of pension funds, burdens can be shared between employers (higher contributions) and employees/pensioners (lower or freeze indexations, higher contributions, lower benefits).

After a referendum, the Swiss government will increase the VAT from 7.6 to 8.0 per cent in order to channel SFR 5 billion to the reserve fund of the first pillar (Eureport, 2010(1-2): 34). The other way around, British municipalities took money from pension funds for public employees due to financial problems which led to unions' protests: 63 municipalities 'borrowed' €3.12 billion with an interest rate of 0.33 per cent (which is less than 1/10 of the market rate). The British government reacted with a new bill which from 2011 will not allow anymore using savings from pension funds for self-financing, while it called upon British pension funds to invest more in domestic infrastructure (Eureport, 2010(1-2): 35). The value of the Swedish Premium Pension assets decreased by 34.5 per cent in 2008 together with deficits of the buffer fund in the first pillar (Eureport, 2009(4-5)), thus affecting although public pensions.

The consequences for individuals depend on private pension plan designs. People might possibly have to postpone retirement (longer working life) or pay higher contributions in the case their pension fund is not applying life-cycle investments which shift assets to more secure investments as retirement approaches. Employees with DC-schemes who are close to retirement are hit harder (decline of asset values means lower pension benefits) than younger employees for whom financial markets and thus rates of return can recover over the next decades. Pensioners covered by DB-schemes are less affected but their benefits could decrease in real value in the case of suspended pension indexation as it is the case in the Netherlands (OECD, 2008a: 6). However, DB schemes provide particular strains on the sponsors – the employer. In the event of bankruptcy of sponsoring firms, pension benefits from DB-pensions (or book reserves) are protected in Germany, Great Britain, Switzerland and Sweden via safety funds. With a growing number of firm insolvencies the contributions to the British Pension Protection Fund probably will be raised from 2012 onwards (Eureport, 2009(7-8): 23). In Germany, contributions (per €1000 in liabilities) to the Pension Protection Fund PSV will increase nearly ten times from €1.8 in 2009 to round about €16.5 in 2010, while the payments of the PSV skyrocketed from €140 million to almost €4 billion in 2010, the highest level in the history of the fund (Bora, 2009). These examples show how important protection mechanisms are, even if combined with higher contributions (to be paid by employers).

Perversely, the past and current financial crises of the 2000s will accelerate the shift from DB to DC benefits, that is, from a more buffered to a more individualized exposure to financial market risks. For example, the financial requirements for Dutch pension funds are installed in a way that turbulences are covered once in 40 years, though already two financial market crises have taken place within the last decade. The reaction to the first crisis was a shift from last-salary to average-career-salary DB-schemes, while the second crisis of 2007/08 led to a further step: a more radical shift from DB to DC schemes or a decrease of DB benefits as well as an increase of the retirement

age (Eureport, 2009(7-8): 24). As a long-term consequence of the financial crisis, the European Commission in its new Green Paper is discussing the introduction of minimum return guarantees in DC schemes and new part-DB / part-DC pension plans as well as more life-cycle-portfolio management. These measures are meant to reduce short-term volatility with long-term consequences for future pension benefits (European Commission, 2010: 14).

Whilst no additional employer contributions due to financial shortfalls are needed in DC-schemes, employers with DB-schemes are faced with higher contributions or lower benefits for younger employees to reduce deficits and re-establish a sustainable funding ratio. In the Netherlands the funding ratio in most pension funds has fallen below 95 per cent, though the required critical minimum funding ratio is 105 per cent. In the Netherlands, the government extended the period for recovery from three to five years together with the requirement to submit recovery plans to the national supervisory authorities (Eureport, 2009(3): 21; Antolin and Stewart, 2009: 128). The average funding ratio in the UK has dropped from 94 per cent in 2007 to 85 per cent in 2008 (Antolin and Stewart, 2009: 128). The same holds true for Switzerland, where funding ratio in the private sector was 96.5 per cent in 2008, while 60 per cent of all funds were underfunded. To balance the funding ratio, pension funds suspended pension indexation and increased contributions (Eureport, 2009(3): 21). The Dutch telecom company TNT, for instance, increased the employer contributions from 20.8 to 39.2 per cent (Eureport, 2009(7-8)), while British-Dutch multinational Shell from 5 to 23 per cent in early 2009 and to 32.1 per cent in June 2009 (Eureport, 2009(6): 25). One of the biggest pension funds in the world, the Dutch pension fund for public employees ABP, temporarily raised the contributions by 1 per cent and from January 2010 onwards by 2 to then 23.3 per cent of salary (Eureport, 2009(4-5): 27). In contrast, American Express is not paying employer contributions for DB and DC pensions in the UK and the US for 18 month (Eureport, 2009(7-8)). Such short-term contribution 'holidays' have long-term consequences for future benefits as the returns on forgone returns will be missing.

Another trend for funded pension institutions is a shift in the type of investments. Equities are more risky than other investments; they led to high losses during the crisis in 2007/08. For this reason, pension funds shifted to more conservative investments, such as bonds and loans, as well as more internationally diversified products/investments (Antolin and Stewart, 2009). In Germany, for instance, fixed-interest securities have in general lower rates of return; they are decreasing since the end of the 1980s. Especially insurance companies use these types of investments. With the portfolio shift of financial institutions towards more bonds and loans the demand in such financial instruments is increasing, but a higher demand caused by the crisis together with stable supply will

lower the rates of return. Since a big part of German pension plans are insurance contracts, indeed pensioners do not have to fear benefit losses but have to expect lower future rates of return.

The regulatory state is answering to these developments with higher supervision and stricter investment rules. The German supervisory authority BaFin, for instance, intensified stress tests of liquidity and solvency margins with the largest insurance companies and pension funds. Similarly, Sweden started more regular analyses of financial institutions' solvency (Antolin and Stewart, 2009: 131). In Britain and Sweden, activities include more frequent coordination and communication between supervisory authorities, financial sector, and policy-makers (Antolin and Stewart, 2009: 131f). In addition, extended recovery periods for pension institutions and lower solvency margins are meant to reduce additional pressures for firms and funds to sell their underperforming equities. Reviews and revisions of the existing investment regulations (rules and decisions) like in Great Britain (Antolin and Stewart, 2009: 138) could improve risk-management and avoid future declines in assets. The European Commission considers new regulations since the current EU-framework does not cover financial accumulation (European Commission, 2010: 14). On the other hand, claims for a pension safety fund in the Netherlands failed because it is not in the interest of the employers who would have to pay the bill with their contributions. Also in Switzerland employers together with financial institutions successfully lobbied for a reduction of the minimum rate of return for occupational pensions to 2 per cent.

10. Conclusion: increased privatization and regulation

Although we often speak of pension privatization, the historical evolution shows wide cross-national diversity in respect to the public regulation and governance of supplementary pensions. Whether occupational pensions are collectively negotiated, employer-provided or individual schemes has major consequences for the overall scope of private pensions and the benefits in retirement. The more state or collective regulation intervenes, the larger the coverage of supplementary pensions and the larger is the scope to pool risks and guarantee rights (Bridgen and Meyer 2009). Encompassing coverage and collective regulation depends on bargaining institutions, the willingness of employers to negotiate, and the overall bargaining coverage as well as state support (*erga omnes* extension of collective agreements). In addition, coverage varies strongly by sector and size of firms due to the varying strength of unions and employers.

The more funded pensions are growing the more importance they gain in financial markets including their ups and downs for pensions and old-age income. The sensitivity to financial market turbulences, however, depends largely on the scope and portfolio of asset investment. The

countries with the largest losses have the highest percentage of equities in their portfolios (OECD, 2009: 34). More risky investments, most notably in the United States and Ireland, but also in the United Kingdom and the Netherlands, lead to higher negative investment returns (from -17% to -26%) than in countries like Switzerland and Germany (-8% to -13%) with more prudent investment in bonds.

The main lessons from the two financial crises within the last decade are stricter rules regarding public supervision (e.g. more regular stress-tests), investment restrictions and partly new benefit protection mechanisms. This indicates that the role of private pension governance, including (state) regulation, continues to gain importance despite the claim of a privatization and retreat of the state. Furthermore, state regulation is complemented by social partners' governance and regulation. The role of trade unions and employers' associations for future old-income age is gaining in importance. In addition to their traditional functions in self-administered state pension institutions in Bismarckian countries, they are now and in the future faced with increasing needs for private pensions due to lower state pensions. Via collective agreements and jointly administered pension schemes the impact of pension finance decisions by employers, trade unions or the social partners together on financial markets is growing since almost all of the new introduced supplementary pensions are funded. The retreat of the state from public pension commitments has not only increased the need to fill the retirement income gap by private funded pensions but leads to demands to better regulate them.

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