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Pension Schemes And "Pillars"

PENSION SCHEMES AND "PILLARS"

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A. Introduction

a) Background

In social protection, the concept of **pillars** is closely linked to the area of pensions. Its choice as a classification system has arisen from the need to make international comparisons of pension systems, an area in which national specificities are marked and comparisons are therefore difficult.

The usual approach towards comparing social protection systems and, in particular, pension schemes is to draw a distinction between *insurance-based* systems (following the "Bismarckian model") and *universal* systems (based on the "Beveridgean model"). However, these models are not strictly applied in the different countries, and national systems combine the two systems at varying degrees.

Another approach towards studying pension systems is to classify pension schemes according to whether they are *public* or *private*. However, here too, the dividing line between public and private is not always clear due to the actions of the different parties involved: public bodies act in the private sector and vice-versa (see Document PS/2003/9: Results by groups of schemes).

Other criteria can also be chosen: compulsory and voluntary, collective and individual, pay-as-you-go and funded (this last criterion does not currently exist in ESSPROS).

The difficulty in finding a common method of classifying pension schemes has increasingly led to the use of the "three-pillar" method for international comparisons. This method classifies the pension schemes in three categories corresponding respectively to state schemes, occupational schemes and personal pension plans. However, the dividing line between pillar 1 and pillar 2 (and thus their respective content) has varied over time and depending on the bodies using this classification. The change is due to the interpretation of the term "occupational", as we will see later.

b) Definition

Several **Commission** documents refer to the pillar classification of pension schemes. For example, the Green Paper on Supplementary Pensions in the Single Market [document COM(97) 283] uses this classification, and it is also referred to in a

Commission Communication entitled "Towards a Single Market for Supplementary Pensions" [COM(99) 134].

These documents give the following definition of the three pillars :

- **Pillar 1** is the basic state scheme, in which participation is generally compulsory. Schemes are generally financed on a pay-as-you-go basis, where current workers' contributions are used to fund the pension payments of retired people. These pension payments are guaranteed by the state, and the scheme is administered by a public institution. At Community level these schemes are coordinated by Regulation 1408/71.
- Pension schemes in **pillar 2** are generally linked to employment or the exercise of a profession (an 'occupational scheme' or 'industry wide scheme'¹). Membership of these schemes is limited to those working in particular sectors, industries, professions or companies, and will be created as a result of agreement between the social partners or by reference to, for example, standards in a particular industry. More often than not, these schemes are funded²: the employer and the employees contribute savings which are invested and will be used to finance pensions in the future. The schemes can be organised in several ways:
 - by setting up or taking part in a pension fund separate from the employer. The fund receives the contributions, invests them and pays out the benefits. Funds are said to be *open* (companies from various industrial sectors can join in) or *closed* (participation is limited to a single company or a group of companies from a given industrial sector). There can be *defined benefits* schemes (the employer guarantees the payment of a given level of benefits) or *defined contribution* schemes (benefits vary according to the returns on the funds invested);
 - by subscribing a group life assurance contract: contributions are paid to a life assurance company which invests them and pays the benefits. The insurance company generally underwrites the payment of the benefits;
 - by purchasing securities through an undertaking for collective investment in transferable securities (UCITS): contributions are used to buy securities. Pension benefits vary according to the returns provided by the securities;
 - using "book reserve" mechanisms: the employer undertakes to pay benefits to his employees and makes provision for commitments on the liabilities side of his balance sheet.

¹ Eurostat's D2 Unit (Structural Business Statistics) makes an annual collection of pension funds statistics in accordance with Regulation 58/97. In the methodological notes on pension funds (see the most recent publication "Special feature on Pension Funds", published only in electronic form in January 2002), the definition of the three pillars is the same as the one given in Part A.b). The pension funds covered by this survey generally correspond to the pension schemes of pillar 2.

Work is underway to compare the ESSPROS data with those of the pension fund survey, with regard to both the coverage (schemes that are included or not in the two databases) and the consistency of the figures for the benefits and contributions of the same scheme.

² The Green Paper quotes the exceptional case in Germany where many companies back pension promises with balance sheet reserves. It also refers to the compulsory French schemes of ARRCO and AGIRC (based on PAYG). However, the scope of Regulation 1408/71 covers benefits created by industrial agreements where they implement an insurance requirement and are approved for this purpose in a declaration by the Member State concerned; France did this in 2000 with regard to ARRCO and AGIRC, which is why these schemes are included under pillar 1.

- **Pillar 3** schemes may be used to supplement the first or second pillars, or both. They have many of the characteristics of defined contribution pillar 2 schemes, although participation is arranged individually by contract directly with a product provider, generally a life assurance company or collective investment undertaking. An individual's contributions are accumulated and invested, and the resulting fund is used subsequently to provide pension benefits for the individual.

c) Political background and ongoing work

As we saw previously (item 3 of the agenda), the work of the Social Protection Committee and the Indicators Sub-group is partly dedicated towards retirement pensions. In this context, certain indicators refer explicitly to the pillars of the pension schemes.

In January 2002, Eurostat consulted the Member States, asking them for:

- definitions of the pillars used in their countries;
- how the schemes are classified within the pillar system of classification.

Answers to the latter question were varied (see the table below), but generally assimilated pillar 1 with basic schemes and pillar 2 with supplementary schemes.

Answers of the Member States on classifications of schemes by pillar

	Pillar 1 / 2 = basic/supplementary	Concept of pillar not used or different	No data per scheme
B (1)			
DK	x		
D	x		
EL (1)			
E (2)		x	
F (3)		x	
IRL	x		
I			x
L			x
NL	x		
A	x		
P	x		
FIN (1)			
S	x		
UK	x		

1) No answer

2) Concept of pillar not used

3) Concept of pillar different from classification of basic schemes and supplementary schemes

B. Difficulties and proposals

Document PS/2003/9 on the results of groups of schemes concluded that there was a risk of establishing a general equivalence between classifying schemes by whether they are basic or supplementary and classifying them under pillar 1 or pillar 2. The answers provided by the Member States to the questions sent by Eurostat in January 2002 confirm the need for clarification of the concept of pillars.

However, the examination of the definitions of the pillars and classifications used by the Member States undertaken in the European Commission's study of May 2000 on pension schemes of the Member States of the European Union³ appears to indicate that the basic schemes **still** belong to pillar 1.

[The pages of a specific document referring to each country will be provided in the meeting.]

A few uncertainties remain with regard to:

- how schemes should be divided between pillar 1 and pillar 2. The result of this problem is that the ESSPROS division between basic and supplementary cannot correspond to the division between pillar 1 and pillar 2:
 - for example, in France the two main supplementary employee schemes (AGIRC and ARRCO) come under pillar 1;
 - in Denmark the labour market supplementary pension (ATP) is also included under pillar 1.
- the status (and classification) of schemes excluded from ESSPROS but meeting the criteria for classification under pillar 2:
 - in France, for example, these are the voluntary schemes for civil servants belonging to the insurance sector (CREF and PREFON).
- the dividing line between pillar 2 and pillar 3:
 - in the United Kingdom, *stockholders* (which replaced personal pensions in April 2001) are classified according to the documents referring to them either under pillar 2 (2002 national strategic reports on pensions) or under pillar 3 (study of the pension schemes of the Member States of the European Union).

Conclusions

Classification by pillar currently provides a reference for retirement scheme analysis. Using the concept of pillars in ESSPROS would involve preliminary classification work for each Member State in breaking down ESSPROS schemes into pillar 1 and pillar 2.

However, a pillar-based approach runs the risk of producing limited conclusions on the retirement systems of the Member States if the classifications of the different countries are not homogeneous. It might therefore be interesting to combine the pillar

³ This study (MARKT/2005/99), which describes the pension schemes of the Member States in terms of pillars, could be used as a basis for classifying schemes by pillar.

criterion with others, such as “basic/supplementary”, “compulsory/voluntary” or even “pay-as-you-go/funded”. (This last criterion does not currently exist in the ESSPROS scheme classification.)

Eurostat would therefore like to ask the Member States the following questions:

- 1) Do the Member States wish to continue work on analysis by pillar or would they prefer to give priority to other types of classification for pension schemes?**
- 2) Are statistics available in the Member States on pillar 3 schemes (for information purposes)?**