CPB Netherlands Bureau for Economic Policy Analysis

Private pensions for Europe

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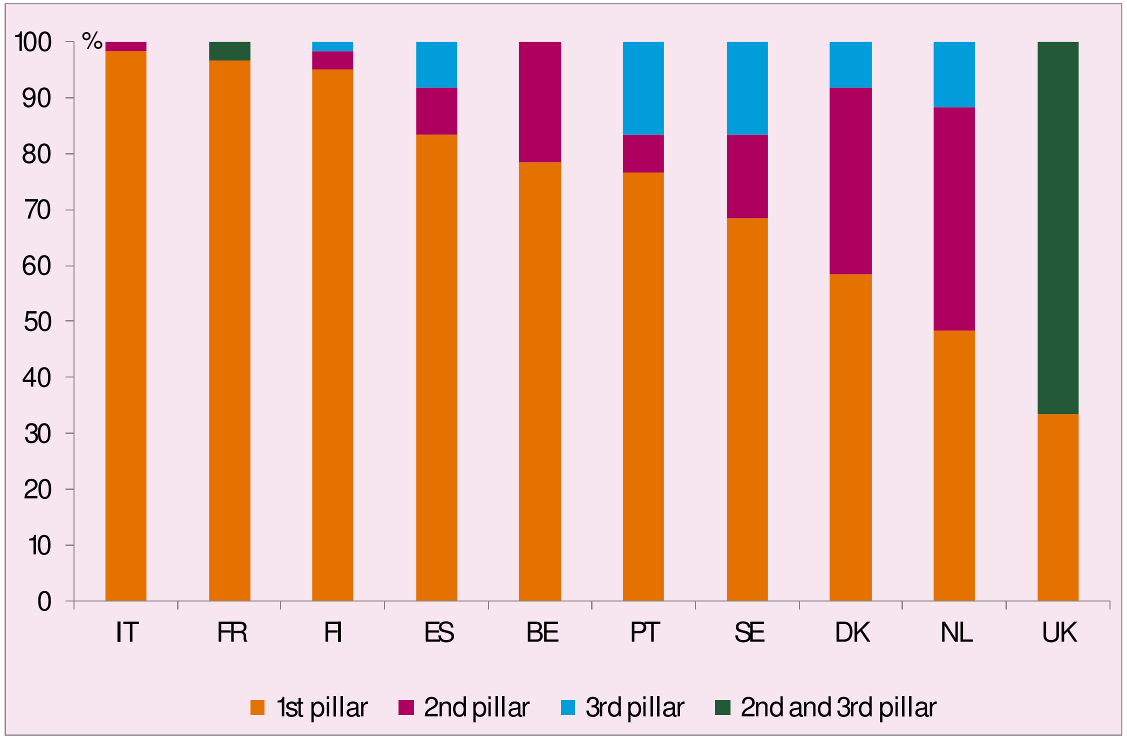
Why this topic?

- Crisis in pension systems due to aging and financial crisis
  - public pensions too costly
  - private pensions: traditional Defined Benefit systems unsustainable

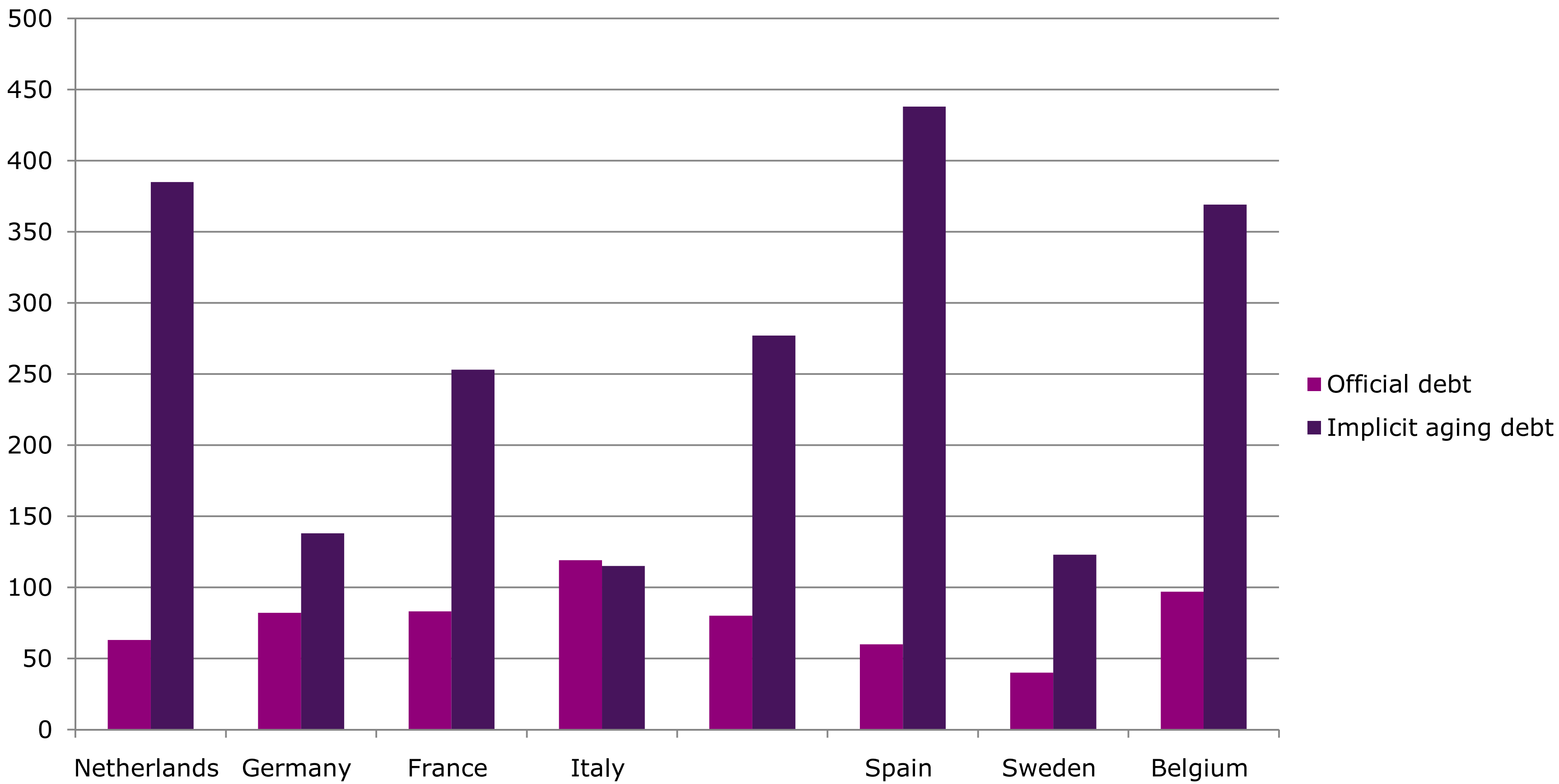
- New balance between pension pillars required

- Green paper (2010) launched debate on EU approach on solvency and social adequacy

Large EU countries rely too much on public pensions



Implicit 'aging' debt important factor behind credit crisis



Three arguments for private pensions

- To keep up pensions when public pensions are being cut to restore sustainability of public finances

- For better diversification of risks

  - reduce exposure to credit risk of 'own' government

  - and diversify (domestic) macroeconomic risks

- Private pensions create deeper EU capital markets

  - pension funds are better able to cope with risk than banks

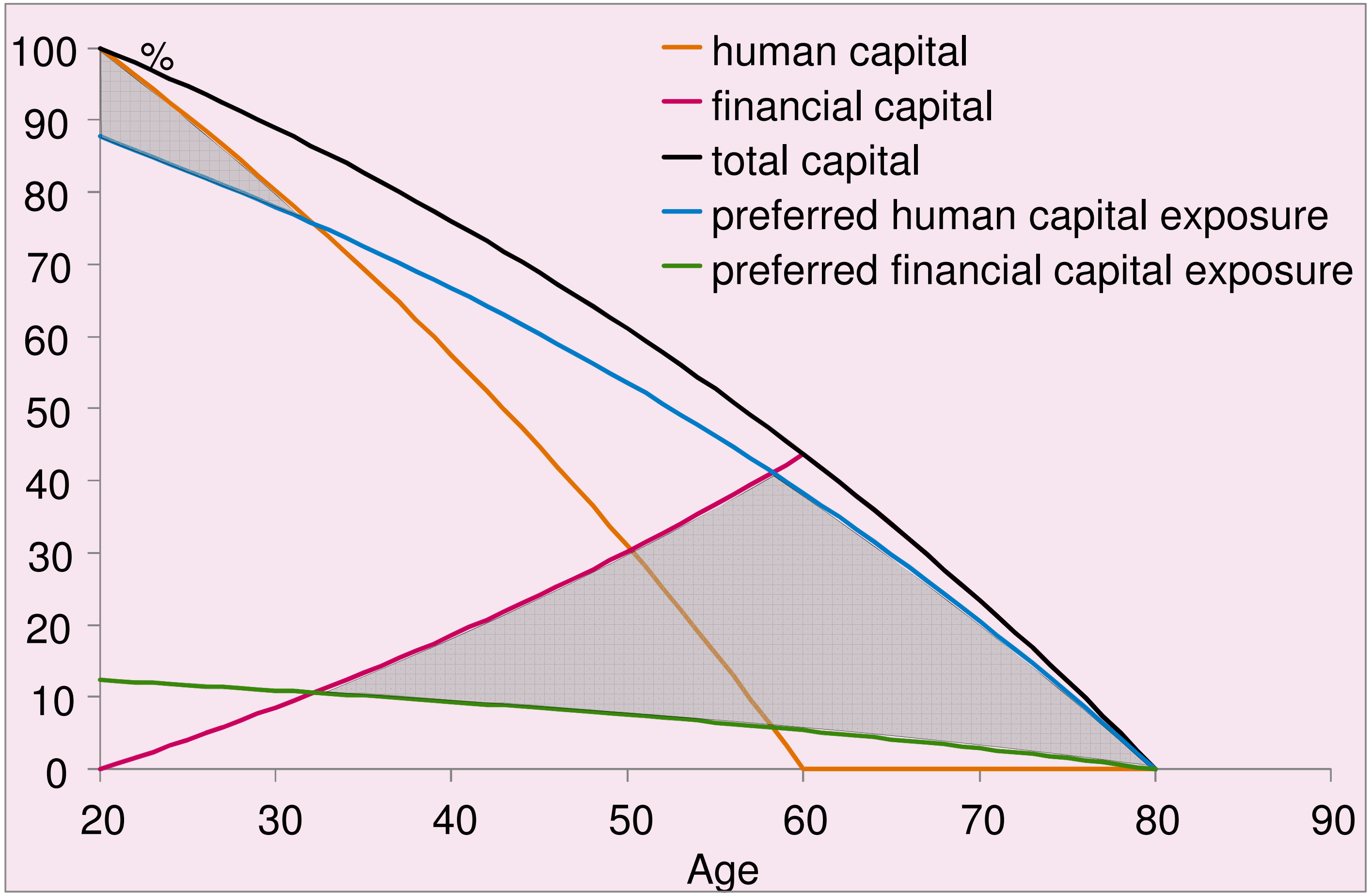
Risk sharing : A good pension is a risky pension

- Pension funds should embrace and share risks
  - individuals benefit from risk premium
  - efficient risk sharing contributes to economic growth

- Intergenerational redistribution of risks
  - the young should share in the financial risks of the old
  - solidarity of the old with shocks in human capital of the young

- How?
  - link pensions of the old - partially - to wages
  - and let the young bear mismatch risk in pension funds
  - government can help providing GDP or wage linked bonds

Exchange risks over the life-cycle



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How to implement private pensions

- Mandatory or semi-mandatory pension saving necessary
  - to avoid undersaving and individual mistakes due to financial illiteracy
  - commitment to risk sharing

- Stand alone pension funds
  - not dependent on firms as risk-bearing sponsors
  - trusted partner
  - implementation according to national preferences
    - e.g. collectives employer / occupation/ regional based
    - e.g. mandatory contract with free choice of provider

- Be careful in imposing unlimited competition and individual choice

Conclusions

1. Stimulate private funding of pensions

2. Good pension should embrace and share macroeconomic risk

   Therefore, supervision should be based on investment perspective rather than insurance perspective.

3. Resist imposing free competition in pension markets