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SUPPLEMENTARY SOCIAL SECURITY SCHEMES: THE ROLE OF OCCUPATIONAL PENSION SCHEMES IN THE SOCIAL PROTECTION OF WORKERS AND THEIR IMPLICATIONS FOR FREEDOM OF MOVEMENT

SUPPLEMENTARY SOCIAL SECURITY SCHEMES: THE ROLE OF OCCUPATIONAL PENSION SCHEMES IN THE SOCIAL PROTECTION OF WORKERS AND THEIR IMPLICATIONS FOR FREEDOM OF MOVEMENT[1]

1. Introduction: Community interests in the area of supplementary pension schemes

1.1 In its Action Programme Relating to the Implementation of the Community Charter of Fundamental Social Rights for Workers[2], the Commission drew attention to the lack of Community provisions protecting migrant workers against the loss of supplementary social security rights. So far, only rights acquired within statutory social security schemes are guaranteed when a worker exercises his/her right to free movement within the Community. As a result, it is feared that important obstacles to labour mobility may still remain.

1.2 The Commission has stressed, especially in its Action Programme Relating to the Implementation of the Community Charter of Fundamental Social Rights for Workers, the diversity of social protection systems in the Member States, a diversity which reflects a history and tradition of social

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[1] In the present communication and as far as pension schemes are concerned, the words 'supplementary' and 'occupational' are being considered as synonymous, as pensions are normally related to income from work and hence to a professional occupation. All these schemes have in common that they originated from initiatives of the private sector rather than being established by government legislation as are statutory social security schemes. Nonetheless, supplementary schemes are considered as part of a national social security system to the extent that they provide benefits which either replace or supplement benefits provided by statutory social security schemes (see article 2 of directive 86/378/EEC). Supplementary pension schemes comprise a pension or benefit plan and a financing method. The pension plan refers to the set of rules defining the amounts of benefits to be paid (including indexation), eligibility conditions for the acquisition of such benefit rights and the financing method to be used. Different financing methods will be discussed below (2.3). The frequently used term *pension fund* refers to pension schemes using a particular financing method, namely pre-funding through a body which is formally separated from the employer and set up for the specific purpose of financing one or several particular pension plan(s).

[2] COM (89) 568 final.

and cultural achievements which is specific to each Member State. The Commission, as it has done in its document "Initial Contributions by the Commission to the Intergovernmental Conference on Political Union" (SEC(91)500), also draw attention to the fact that there is no question of a general harmonisation of the existing systems. Supplementary social security schemes usually form an important element of the overall social protection of workers, and it is up to the Member States to decide by what combination of statutory and supplementary schemes the objectives of social protection are to be met. Each Member State must remain free to chose amongst the different fundamental options which are available for the organisation of retirement provision: the choice between collective and individual provision; the choice between public schemes, schemes based on collective conventions and private schemes; the choice between pay-as-you-go financed and funded systems. The Commission does, however, consider that too great a divergence of social protection levels can hinder the free movement of workers and aggravate regional disparities within the Community. The Commission has therefore proposed a strategy for the convergence of social protection objectives and policies in order to reduce the aforementioned risks without destabilising the national systems[3].

1.3 With regard to free movement of persons, the Commission recalled that appropriate measures for the implementation of article 49 of the Treaty had been progressively adopted but that there are still some areas where further action might have to be considered. This is in particular the case with regard to the absence of coordination of supplementary social security schemes on the basis of article 51 of the Treaty (it should be noted that the question of decision making on the basis of this article is under discussion at the Intergovernmental Conference). Thus an important obstacle to the development of labour mobility from one Member State to another may still remain. As a matter of fact, guaranteeing supplementary social security rights of migrant workers is very complicated, given the diversity and large number - even on a national level - of supplementary schemes.

1.4 For these reasons the Commission has opted for a careful and gradualist approach, starting with a communication in order to stimulate a Community-wide debate. Furthermore, it appeared useful to single out pension schemes which are in many countries the most important

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3 See the *Community Charter of Fundamental Social Rights for Workers*, article 10. The Commission's action programme relating to the implementation of the Charter proposes a recommendation on the convergence of objectives and policies in the area of social protection. A draft recommendation has been adopted by the Commission on 26 June 1991 (COM (91)228).

element of supplementary social protection. Other issues, and in particular supplementary health insurance, will be dealt with in a future communication.

1.5 The present communication will examine supplementary pension schemes from two different but closely related angles. In the first part, their actual and potential contribution to the overall social protection of workers will be discussed. In the second part, their implications for freedom of movement for workers will be analysed. The main characteristics of pension schemes in each Member State are summarised in the appendix.

1.6 The Commission is currently also working on a draft directive on pension funds. Whilst the present communication deals with the subject of occupational pensions from the viewpoint of free movement of workers (by analyzing obstacles to labour mobility and by encouraging cooperation at the Community level which should lead to a greater convergence of national policies and systems), the draft directive deals with the functioning of pension funds as financial institutions in the Internal Market.

1.7 The aim of the present communication is to start a discussion at Community level, involving anyone with an interest in supplementary pension schemes, on the role of such schemes and their impact on the free movement of workers.

2. The place of supplementary pension schemes in the social protection of workers

2.1 Supplementary pension schemes in the context of the 'three pillars' of retirement income

2.1.1 Income in retirement is usually considered to be based on three systems of which the first represents statutory pension schemes, the second occupational pension schemes and the third individual retirement provision through savings and life assurance contracts as well as investment in real assets and property. The three systems of retirement provision are highly interdependent, to such an extent that it would actually make sense to talk about three segments of a single column rather than three independent systems. Whilst the structure of the aggregate or the relative weight of each of the systems varies considerably from one Member State to another, one can safely assume that, across the Community, individuals in comparable circumstances have similar aspirations as far as their relative living standard (compared to previous earnings) during retirement is concerned. As a matter of fact, the aim of retirement provision is usually not just to ensure a level of income sufficient for subsistence during retirement but to reach a living standard similar to the one achieved during one's career. Differences in individuals' aspirations appear to be less marked across the Community than differences in the design and structure of the systems of retirement provision which can be found in the Member States.

2.1.2 Supplementary pension schemes are extremely diverse and in the present communication no comprehensive overview can be given of these schemes in the Community. Their contribution to overall social security in any given Member State differs widely, depending on the percentage of the total population covered by such schemes, eligibility conditions, the amount and structure of benefits paid to individuals by these schemes, the quality of the benefit promise (whether it is an enforceable right) and the quality of inflation or earnings indexation of benefits in payment, such indexation being an important safeguard against inflation. The contribution of supplementary schemes to overall social protection will often reflect the lacunae of statutory social protection, although individuals cannot necessarily expect in all situations that supplementary schemes will automatically fill all the gaps left by statutory schemes. In order to develop into an adequate complement to statutory social security, supplementary schemes need a favourable legislative framework, especially as far as tax law is concerned, and good cooperation between the two sides of industry.

2.1.3 Supplementary pension schemes differ with regard to their scope as far as their membership is concerned. In the light of the social policy objective of guaranteeing an adequate level of retirement income to all workers, the fact

that the coverage of supplementary schemes is not as comprehensive as the coverage of statutory schemes has to be seen as a major drawback of occupational pension schemes. There can be considerable disparities within the workforce and sometimes very unequal levels of social protection depending on where and how a worker is employed (part-time and temporary employment vs. full-time employment of indeterminate duration, size of the company and sector of activity). Indeed, many workers are not covered at all by a supplementary scheme although it should be kept in mind that not all workers need such supplementary cover to the same extent, low-paid workers being usually guaranteed a high level of income replacement by the statutory schemes of most Member States.

2.1.4 Membership in supplementary schemes can range from selected groups of employees or even individual employees within one company to all employees of a country in the case of nation-wide collective agreements creating a compulsory pension scheme. Schemes can be set up for a whole sector or industry of the economy, such as the public sector. Some schemes are limited to particular professions. Another important distinguishing feature is the degree to and the level at which membership in schemes is mandatory. Individual workers may have a legally protected right to opt out of an employer's scheme or at least be able to negotiate membership in a scheme as part of their employment contract. In other Member States, not even employers may be free to opt out of a national, sectoral or professional supplementary pension scheme.

2.1.5 The quality of the social protection for retired workers resulting from supplementary pension schemes varies considerably, depending on how the schemes are designed and how their financial viability is safeguarded. In a fully indexed final salary scheme, retired workers would receive an inflation- (or earnings-) adjusted pension related to their last earnings. Pensioners are assured of a constant absolute or relative (compared to workers) living standard during the entire period of their retirement. Hence, they will only bear the risk of insolvency of the scheme or the employer, a risk the effects of which should be minimised by an efficient and appropriate actuarial supervision in the case of a pre-funded scheme, compulsory insolvency insurance in the case of book reserves or compulsory membership in the case of pay-as-you-go schemes.[4] However, such *fully indexed* final salary schemes are not very common. The opposite extreme in terms of risk sharing between members and the scheme are defined contribution plans where contributions are credited to an individual's account and no benefit promise is given beyond what can be paid for out of this accumulated capital. The contributions and accrued investment returns are simply accumulated on behalf of an

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[4] See below (2.3) for more details on these financing methods of pension schemes.

individual worker and then, after retirement, paid out in the form of a lump-sum or of an annuity. These schemes can almost be considered as a form of individual saving. Workers and pensioners bear a much greater share of the risks involved in retirement provision, as factors such as inflation, asset prices and investment returns will affect directly the financial position of a (present or future) pensioner. Across the Community, many different ways of dealing with the risks of retirement provision and especially of sharing it among workers, employers, pensioners and, possibly, the state can be found.

2.1.6 Supplementary pension schemes can also be distinguished by examining who established and who runs them. This will also have an influence on the design and structure of supplementary social protection. On the one hand are schemes created by employers and run exclusively by them; the other extreme are schemes set up by the protected persons themselves, as is necessary in the case of self-employed workers. Between the two extremes, various forms of cooperation between employers and employees can be found, ranging from joint management, usually based on collective agreements, of schemes by the two sides of industry to various forms of employee participation.

2.2 Public policy and collective retirement provision through statutory and occupational pension schemes

2.2.1 In both the first and the second pillars, retirement provision is largely collective and the freedom of individual workers not to become a member of some pension scheme is very limited, even if the *employer* may be free not to establish a scheme or not to offer membership in it to some of the employees. Retirement provision is largely compulsory for individual workers whose personal initiative is usually limited to the third pillar, i.e. additional personal savings, life assurance contracts and the acquisition of real property.[5] The fact that retirement provision in the first two pillars - which represent by far the most important sources of income during retirement - is largely compulsory for workers can be explained by the observed tendency of individuals not to make sufficient provision by themselves. Especially younger workers may not realise how much effort is necessary during the whole

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[5] Workers may, however, have the possibility to exercise individual choice by deciding into which scheme a given amount of contributions is to be paid. This can be linked to the right, for the worker, to *opt out* of their employers' schemes or even the statutory scheme so that contributions are available for another 'personal' pension scheme which are offered by insurance companies and other financial institutions. Workers may also be free to make additional voluntary contributions into first and second pillar schemes.

working life in order to secure a reasonable income during retirement. Furthermore, collective forms of retirement provision diminish the individual risks which are always involved in long term savings decisions.

2.2.2 By making retirement provision compulsory for individuals and by pooling risks, first- and second-pillar pension schemes reduce the risk of poverty during old age and the likelihood of an individual having to claim social assistance after retiring from work. In most Member States, collective pension schemes have significantly reduced the incidence of poverty amongst the elderly. Public policy is largely responsible for this success, be it directly through the running of a statutory pension scheme or indirectly through various measures designed to encourage private initiative in the area of retirement provision.

2.2.3 Public policy influences the second pillar of retirement provision through various channels. By determining the type and extent of coverage imposed on workers by the compulsory first pillar, a more or less large gap is left to be filled by the other two pillars. Virtually no state pension scheme fully satisfies the expectations of all categories of workers, although low-paid workers may find it possible, in many Member States, to maintain their living standard during retirement.

2.2.4 Higher-paid workers, by contrast, will, in almost all Member States, not be able to maintain their living standard during retirement by relying exclusively on the first pillar, especially if the first pillar pays a flat rate pension to all *residents* of a country. Statutory pension schemes which calculate benefits only on the basis of income below an upper earnings limit or which offer only a low replacement rate (the amount of the state pension expressed as a percentage of earnings before retirement) will also leave more scope for the second and third pillars.

2.2.5 Whether and how the second pillar fills the gap left by the statutory pension scheme depends on the general legal framework in which occupational pension schemes can operate and on their fiscal status. Governments usually grant tax deductibility at both employer and employee level for contributions to pension schemes. Some Member States limit the deductible amount for contributions. Most Member States do not tax investment income of pension funds By contrast, benefits, i.e. pensions, are usually taxable. Pension schemes wishing to benefit from a favourable tax status will have to conform to certain conditions set by the legislator. Thus governments have an indirect way of influencing such schemes.

2.2.6 Some countries also regulate pension schemes directly, subjecting them to more or less stringent rules concerning such matters as financial management, disclosure of information about the rights of beneficiaries and the financial situation of the scheme, participation of

beneficiaries in running the scheme, revaluation of benefits, vesting requirements (minimum periods of scheme membership) and the eligibility for scheme membership and benefits.

2.2.7 Public policy also seems to have some influence on the extent to which a fruitful cooperation between the two sides of industry can develop in the area of pension schemes. In the most extreme case, the legislator can make mandatory for a whole industry, profession or even the entire workforce of a country a pension scheme based on a collective agreement. But even if there is such strong government backing for supplementary pension schemes, the initiative for establishing a scheme remains in the hands of the private sector.

2.3 *Financing methods of pension schemes*

2.3.1 The financing methods of supplementary schemes are very different as well. Whilst in most countries different financing methods coexist, particular methods tend to be dominant in different countries, usually depending on which methods are encouraged (or even prescribed) or discouraged by the authorities. Three types can be distinguished: In most countries *pre-funding* tends to be very common. This means that contributions are used to build up a capital stock (regularly increased by investment returns on the capital accumulated in the past) which is deemed to be sufficient to meet the pension promises which have been made to the members of a scheme. Many Member States require pension promises to be backed up by such a capital fund the assets of which can be held and managed by a pension fund for the exclusive benefit of its members or in the form of a group insurance contract with a life assurance company.

2.3.2 Some countries allow an alternative approach, namely *book reserves*. Rather than accumulating real or financial assets which can be liquidated in order to pay out pensions, firms retain the contributions and pay pensions out of their revenue. Expected pension liabilities are shown in the balance sheet. This financing method works under the assumption that the company will generate sufficient revenue for as long as pension liabilities are still outstanding, i.e. possibly half a century into the future. If the company collapses or shrinks significantly, then possibly not all promised pensions can be paid. As a result, national authorities may require companies to pay contributions to an insolvency insurance scheme which can guarantee pension liabilities in the event of insolvency of the employer.

2.3.3 A third financing method, '*pay-as-you-go*', is typical of statutory pension schemes but rather exceptional in the case of occupational pensions. Under this method, no (or only insignificant) capital reserves are accumulated to back up pension promises. The contributions are used to pay out directly the benefits of current pensioners. Similarly

to book reserve schemes, the pay-as-you-go system requires a certain stability, albeit of a somewhat different nature. Benefit payments to pensioners in a pay-as-you-go scheme are only guaranteed if there is a regular contribution income which requires a more or less constant intake of young scheme members to pay these contributions. Alternatively, the scheme could be backed by a state guarantee. Demographic decline or decreasing earnings (e.g. as a result of high unemployment) will have immediate repercussions on the financial equilibrium of pay-as-you-go schemes, requiring either benefits to be lowered or contribution rates to be raised.

2.3.4 The constant flow of contribution income which is necessary for the long-term financial stability of pay-as-you-go schemes can be ensured through compulsory membership being applied to as large a group of workers as possible. Alternatively, the higher risks of membership fluctuations in small schemes can be pooled, and thereby reduced, if several schemes agree on transfer payments compensating for strong demographic or economic fluctuations affecting only particular schemes. The pay-as-you-go financing method is normally not considered suitable for occupational pensions which are organised on a company or sectoral level or for a particular profession where fluctuations in potential membership can be important. Most second-pillar pension schemes are therefore pre-funded.

2.3.5 Even if they cannot recruit new members, pre-funded pension schemes should normally have sufficient funds to enable them to pay the promised benefits until the last survivor of the last pensioner dies. They therefore appear to be immune to changes in the number of active members in the scheme. This lets funded schemes appear as an attractive alternative to pay-as-you-go schemes in the light of the forthcoming deterioration of the demographic balance between workers and pensioners.

2.4 Demographic change and supplementary pension schemes

2.4.1 In future decades, far fewer workers will have to sustain a largely increased number of pensioners. This is widely seen as a threat to the (mostly statutory) pay-as-you-go pension schemes which, in order to maintain their financial equilibrium, will either have to raise contribution rates or reduce benefits to future pensioners (by cutting the benefit rate or by shortening the period during which they are paid, i.e. by raising the pensionable age). As far as the statutory schemes are concerned, governments will probably try to strike a balance between the interests of workers and pensioners by using a combination of these possible measures. At the same time, the boundaries between pay-as-you-go and pre-funded retirement provision are being reconsidered on the grounds that pre-funded schemes, be they private or public, are

perceived to be more robust in the light of demographic changes.

2.4.2 This perception of pre-funded private pension schemes as being relatively immune against demographic change may, however, be illusory. The implicit effect of any form of pension provision, regardless of the financing method, is to share the resources available for consumption between workers and pensioners. As the demographic balance between these two groups changes, so do the possibilities of channelling resources towards the pensioners. Pre-funding can only overcome this basic problem if it increases the total resources available for consumption by a given community several decades after the funding has actually taken place. This will only be the case if either the funds set aside for future pensioners are invested abroad through a positive trade balance followed by a trade deficit when the pensions are due, or if pre-funding increases the production equipment of the economy so that it becomes more productive and can hence more easily afford the future expenditure on pensions. Whether pre-funding does actually have these effects on available resources in the future is subject to controversy. Nevertheless, pre-funding may in a sense improve the bargaining position of pensioners in as much as they hold assets to back their claim on the available resources. The value of these assets may, however, effectively be reduced, whether through the normal market mechanism of supply and demand (which is likely to reflect the demographic balance), through inflation or through direct political measures such as property taxation.

2.4.3 The development of pre-funded pension schemes or the accumulation of substantial reserves in current pay-as-you-go schemes could also have major effects on the economy of the European Community and its Member States. In the light of the current world-wide shortage of savings (or rather investment) a more widespread use of pre-funding as a financing method for retirement provision might be welcome as a source of long-term capital and hence as a contribution towards faster non-inflationary growth. In the short run, however, the effects on aggregate demand would have to be taken into account which might result in increased contractual household savings (through pension funds and insurance companies) being offset by lower savings in the corporate sector resulting from diminished profits. As a result, given the considerable macroeconomic importance of financial flows related to retirement provision, any change in the way pensions are financed is likely to have far-reaching consequences and should therefore be carefully considered in the light of the macroeconomic situation of the moment. This is all the more important as sustained economic growth resulting in the creation of more and productive jobs is crucial for reducing the relative financial burden of pension expenditure and for extending the room for manoeuvre of governments.

2.4.4 The effects of national decisions regarding the financing of retirement provision will also almost certainly spill over the national borders. For this reason it would be crucially important for the Community to establish an exchange of information and to stimulate closer cooperation among the Member States on these matters.

2.5 Social policy objectives and the regulation of supplementary pension schemes

2.5.1 Occupational pension schemes will not just reflect the need of workers to increase their retirement provision in view of the insufficiency of statutory schemes. If they are set up by employers, they will typically respond to the employer's need to attract and retain qualified employees. These requirements in terms of personnel management will therefore influence the design of occupational pension schemes. By granting benefits preferably to employees who worked for the same employer for many years or even until retirement, employers can reduce their employee turnover. There are indeed some schemes which will pay benefits only to workers who retire from employment with the particular company for which the scheme was set up. Such arrangements linking benefit entitlements to a worker's employment history with a particular company will obviously make labour mobility more costly for employees. They will also slow down the development of new and fast growing sectors, as employers in these sectors would find it very costly to recruit labour, and skilled workers in particular.

2.5.2 Occupational pension schemes will also enable employers and workers to save on tax to the extent that contributions to pension schemes are tax deductible. Even if benefits are eventually taxed (as is usually the case), workers can sometimes reduce their life-time tax bill by avoiding the higher marginal tax rates to which they would normally be exposed during their periods of well-paid employment.

2.5.3 Given these additional roles of supplementary pension schemes as personnel management tools and tax saving device, there is no guarantee that these schemes will automatically contribute to the social policy objective of an adequate and secure level of income replacement for *all* retired workers, regardless of their particular employment history. This objective is reflected in a more or less strict regulation and supervision of pension schemes. In various countries, many of these legal obligations result from court rulings which sometimes have to fill a 'legal vacuum'. However, to the extent that many supplementary pension schemes are voluntary, governments have to accept that such schemes are not perfect in terms of their public policy objective and may refrain from preventing employers from using their pensions schemes also as a personnel management tool.

2.5.4 Regulation of supplementary pension schemes is a complex issue and its effects on the development of private retirement provision in the second pillar are difficult to assess. Whilst it is possible that regulation leads to the creation of (especially compulsory) supplementary schemes, there is some fear that tight regulations might increase the reluctance of some employers to set up and maintain occupational schemes. In practice, however, there certainly does not appear to be a positive correlation between the absence of regulations and the importance of such schemes in the various Member States.

2.5.5 What seems to be important, for the development of voluntary occupational schemes, is the *quality and stability* of this legal framework which directly affects the expected cost of running a benefit programme. Sudden changes in this legal framework make it very difficult for employers to calculate the real long-term cost of their benefit schemes which has to be assessed over several decades. Legislation, while improving the social protection of workers, can also provide guidance for employers who want to set up occupational pension schemes and who have a large choice of possible pension scheme designs. As a result, it would be wrong to consider that regulation of occupational retirement provision is an area where the interests of employers, workers, pensioners and the government will necessarily clash. Legislation recently introduced in various Member States proves that a consensual approach is possible and can be very fruitful. This need for stability of the legal framework will have to be taken into account by any public policy dealing with voluntary occupational retirement provision. This is true at both Community and national level.

2.5.6 There has been only very limited regulation of supplementary pension schemes at Community level. Two directives were adopted asking Member States to protect the interest of current and past workers also as far as their supplementary social security rights are concerned. The two directives apply only to very specific circumstances, namely the transfer of ownership of undertakings, businesses or parts of businesses[6] and the case of insolvency of an employer.[7]

2.5.7 Another respect in which occupational schemes are regulated at Community level is the equality of treatment between men and women. In this area, a directive was adopted by the Council in 1986[8] and a further directive was proposed by the Commission in 1987, with the aim of eliminating different treatment of men and women, also as far as the

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[6] Directive 187(77)EEC, OJEC n. L 61 of 5 March 1977.

[7] Directive 987(80)EEC, OJEC n. L 283 of 28 October 1980.

[8] Directive 378(86)EEC, OJEC n. L 225 of 12 August 1986.

pensionable age and survivors' benefits are concerned.[9] Furthermore, the Court of Justice of the European Communities consistently maintained the view that occupational retirement benefits are to be considered as pay in the meaning of article 119 of the Treaty.[10] This article outlaws pay discrimination based on sex. The most recent judgment in the Barber case (see note 10) is likely to have an impact on the desirable equalisation of pensionable ages for men and women in statutory schemes as well.

2.5.8 Commission proposals for directives concerning certain employment relationships, namely part-time, temporary and interim employment, are currently before the Council. One of these directives would require that workers in these particular employment relationships will be afforded social protection under statutory and occupational social security schemes in the same foundations and the same criteria as workers in full-time employment of indeterminate duration.[11] Adoption of this directive might increase the number of employees being covered by such schemes.

2.5.9 In its Action Programme relating to the implementation of the Community Charter on Fundamental Social Rights for Workers[12] the Commission also announced a proposal for a recommendation on the convergence of objectives and policies in the area of social protection. The aim of this convergence strategy is not to promote a harmonisation of the national designs of social security systems but to achieve a greater similarity in the degree of social protection offered to workers throughout the Community.

2.5.10 The second life assurance directive adopted on 8 November 1990[13] also covers group assurance and will, as a result, enable pension schemes to finance their liabilities by using an insurance contract with a life assurance company established anywhere in the Community. It will also become possible to establish, in the form of a captive life assurance company, a single financing vehicle for all national pension schemes of a multinational employer. The possibility of opening up similar possibilities for pension funds is currently being examined by Commission services and

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[9] COM(87)494 final.

[10] See in particular the judgments of the Court of 13 May 1986 in Case C-170/84 between Bilka-Kaufhaus GmbH and Karin Weber von Hartz, and of 17 May 1990 in case C-262/88 between Douglas Harvey Barber and Guardian Royal Exchange Assurance Group.

[11] Proposal for a Council directive on certain employment relationships with regard to distortions of competition. COM(90) 228 final - SYN 280 of 13 August 1990.

[12] See above, note 2.

[13] Directive 619(90)EEC, OJEC n. L 330 of 29 November 1990.

civil servants from the Member States. A pension fund directive, to be proposed by the Commission in the near future, would achieve some progress in this direction and allow cross-border financing arrangements also in the case of pension funds.

2.5.11 Pension schemes are also likely to benefit from an increased freedom to invest throughout the Community. Council Directive 88/361/EEC of 24.6.1988 implementing Article 67 of the Treaty liberalises completely and unconditionally all capital movements in the Community as of 1 July 1990. Within this legal framework some prudential rules imposed by Member States on institutional investors such as pension funds will have to be reconsidered in order to eliminate any remaining direct or indirect obstacles to the freedom to invest anywhere in the Community which are not justified by the exchange rate risk. The Commission takes the view that, prima facie, some restrictions (e.g. localisation requirements, minimum investments in certain instruments, any restrictions or conditions discriminating against investments in shares or bonds issued or listed in other Member States) go well beyond what is necessary for prudential reasons. It will take the appropriate steps in the near future in order to ensure that these restrictions are either abolished or changed so as to become compatible with Community law.

3. The implications of supplementary pension schemes for freedom of movement of workers

3.1 Coordination of statutory social security schemes and its applicability to supplementary pension schemes

3.1.1 Freedom of movement for workers is one of the basic constituents of the common market,[14] a market not only for goods and services, i.e. the economies' output, but also for production factors, i.e. labour and capital. Currently, the European Community is moving even further, towards a freedom of movement of all persons.[15] It was already clear at the time of the drafting of the Treaty Establishing the European Economic Community that, in the absence of Community guarantees for the social security rights of migrant workers, labour mobility within the Community would still remain severely limited by national boundaries as workers could not afford losing their pension rights or their rights to adequate cover against health and other social risks. The territorial limitations of national social security schemes had to be overcome, enabling workers and pensioners to draw statutory benefits anywhere in the Community and to aggregate, to the extent that this is required by the legislations of the Member States, periods of work, contribution payment or residence which are necessary for the acquisition of rights. Article 51 of the Treaty therefore states that:

> The Council shall, acting unanimously on a proposal from the Commission, adopt such measures in the field of social security as are necessary to provide freedom of movement for workers; to this end, it shall make arrangements to secure for migrant workers and their dependents:
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> (a) aggregation, for the purpose of acquiring and retaining the right to benefit and of the calculation of benefit, of all periods taken into account under the laws of the several countries;
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> (b) payment of benefits to persons resident in the territories of Member States.

3.1.2 The rules indicated in article 51 were applied to *statutory* social security schemes where obstacles to the free movement of workers have been largely eliminated. The arrangements referred to in article 51 are known as 'coordination of social security systems' the precise rules of which were laid down in regulations (EEC) 1408/71 and

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[14] See Article 48 of the Treaty Establishing the European Economic Community.

[15] Article 8a of the Treaty and the recent directives on the right of residence, 364(90)EEC, 365(90)EEC and 366(90)EEC, all published in the OJEC n. L 180 of 13 July 1990.

574/72. However, these regulations have never been extended to *supplementary* social security schemes, nor have analogous legislative instruments ever been adopted in this area.

3.1.3 In fact, the rules specifically mentioned in article 51 are less pertinent in the case of supplementary schemes than they are in the case of statutory schemes. As far as the second rule is concerned (indent (b)), it has to be noted that the payment of supplementary benefits is in principle already possible anywhere in the Community. Any restrictions on transfers of benefits or accumulated contributions from supplementary pension schemes would be contrary to the principle of free movement of capital.[16] Furthermore, being private institutions, supplementary pension schemes are most unlikely to be able to impose any conditions of residence on beneficiaries. In practice, the exportability of supplementary benefits, unlike statutory benefits in the absence of coordination, does not seem to pose any major problems.

3.1.4 Whilst the second rule (indent (b) of article 51) makes statutory social security benefits exportable, the first rule (indent (a)) deals with the acquisition of rights to such benefits. The aim is to make it immaterial, for the acquisition of statutory social security rights, whether a worker has spent his/her whole working life in a single country or whether he/she has worked in several countries of the Community. This puts migrant and non-migrant workers on an equal footing.

3.1.5 The method indicated in indent (a) of article 51 for achieving this purpose addresses a clear handicap for cross-border migrant workers. National job changers would be able to acquire social security rights, no matter how often they changed jobs within a given country. By contrast, in the absence of coordination of national social security systems, a migrant worker who worked in several countries might fail to complete the minimum service periods for acquiring a right to social security benefits in each of his/her countries of employment and thus remain without social security during the entire career. As a result, cross-border mobility would have exposed workers to unacceptable risks. The difference between cross-border mobility and intra-national mobility is not as important in the case of supplementary social security schemes because, in many cases, even intra-national mobility can make the acquisition of (supplementary) social security rights more difficult or even impossible.

3.1.6 Coordination essentially addresses the penalisation of cross-border mobility compared to intra-national mobility. This penalisation does also exist in the

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[16] See Council directive 88(361)EEC of 24 June 1988 for the implementation of article 67 of the Treaty, OJEC n. L 178 of 8 July 1988.

case of supplementary schemes, given that obstacles to mobility may already have been eliminated at the national level or to the extent that sectoral schemes are dominant and most of the labour mobility takes place within a given sector. However, the main public policy issue, as far as supplementary pension schemes are concerned, is to facilitate labour mobility, and hence labour market flexibility, and to ensure that job changers are not penalised as far as their social protection is concerned. The problems for migrant workers in the case of supplementary schemes are, on the whole, of a different nature from those which arise in the area of statutory social security schemes, as will be shown in the following paragraphs. A different approach is therefore necessary and the methods of coordination, as they are laid down, on the basis of article 51, in regulation 1408/71, are difficult to apply, as such, to supplementary schemes.

3.2 Supplementary pension schemes and obstacles to the free movement of workers

3.2.1 Supplementary pension schemes would normally privilege the interests of current scheme members, as opposed to scheme leavers (i.e. workers who leave the scheme before retirement and either take their rights out of the scheme or maintain their rights in it). Many features of such schemes will penalise scheme leavers, and individuals who frequently change jobs would usually finish their career with significantly reduced benefit entitlements. This problem has to be addressed at the Community level to the extent that it penalises cross-border mobility more that intra-national mobility.

Acquisition of rights

3.2.2 *Vesting requirements and waiting periods* can be a particularly important cause for reduced pension entitlements after a career with frequent job changes. Waiting periods refer to the time one has to be employed with a company before becoming eligible for benefits from the scheme. By vesting is meant the creation of a recognised pension entitlement. Usually, conditions for vesting cannot be set freely by employers who could, in the absence of such legal constraints, confer a pension right only at the time of retirement. Any employee leaving a job before retirement would therefore obtain no pension entitlement for this particular period of employment. Consequently, national legislations usually require rights to become vested and put limits on vesting periods, but these limits vary considerably across the Community, ranging from immediate vesting to vesting at retirement.

3.2.3 Comparable qualifying conditions do also exist in the case of statutory social security schemes but their inconvenience for migrant workers was removed by the coordination of national social security systems which

requires national authorities to assimilate periods served abroad to periods served in the domestic economy. Because of their diversity and large number, it is difficult to conceive how a similar rule of aggregation of service periods could be imposed on supplementary pension schemes.

Preservation or transfer

3.2.4 If a job leaver has obtained a vested right it will be necessary to decide what to do with this right. Two possibilities exist: Rights can be maintained in the pension scheme in which they were acquired, and the job leaver will be able to draw a pension from this scheme once he/she retires. The alternative is to pay out a capital value representing acquired rights.[17] This capital value can then be used to buy a deferred annuity from an insurance company or to pay it into the new pension scheme, provided of course the new scheme accepts the transfer.

3.2.5 Capital transfers seem to be a straightforward solution in the case of funded pension schemes, but would not normally be used in the case of book reserve plans and pay-as-you-go schemes, both of which do not set aside financial assets to back up their pension promises. Many job changers will therefore only have the option of maintaining their rights in the previous pension scheme[18]. In either case - transfer or preservation - future pay rises will not normally be taken into account as they would be after an uninterrupted career with the same employer. Frequently, not even (expected, in the case of a transfer) price or average earnings rises are taken into account for the adjustment of preserved rights or for the calculation of transfer values. As a result, there is a tendency for scheme leavers not to get their fair share out of a pension fund.

3.2.6 Long vesting and waiting periods, calculations of transfer values which penalise scheme leavers and inadequate preservation of 'dormant' rights are severe obstacles to labour mobility. In the presence of these obstacles the contribution of occupational pensions to the total retirement incomes of workers will depend on careers which are characterised by long, uninterrupted periods of employment with the same company or employer. The social policy goal of guaranteeing an adequate retirement income will not be achieved for workers with a more mobile career profile.

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[17] Ideally, this capital value includes both employer and employee contributions as well as accrued interest at a realistic rate.

[18] This would also be the case if the new employment relation does not provide for membership in an occupational pension scheme.

3.2.7 One particular category of workers likely to be most affected by this implicit preference for long-term employees are women. Many of them tend to interrupt their careers for family reasons. When they return to the labour market, they may not resume employment with the same employer and they may only be able to get part-time jobs and not very secure employment. As a result of vesting and waiting periods, unfavourable transfers and inadequate preservation of 'dormant' pension rights, women will be far more likely than men to receive insufficient occupational retirement benefits. This will be especially problematic in countries where occupational pensions are supposed to be a major source of retirement income.

Taxation of transfers

3.2.8 A problem which specifically affects international migrant workers is related to taxes. Tax authorities usually grant tax exemptions for contributions to and investment income of pension schemes, but they expect to be able to levy income tax on the retirement benefit once the worker has retired. This will not be the case if the capital value of contributions and accrued interest is transferred abroad. National tax authorities will not be able to ensure that this accumulated untaxed income will indeed be used for financing a pension. Nor will they be able to tax these retirement benefits if they are paid out abroad by a foreign pension scheme. As a result, national tax authorities may levy very substantial taxes on transfer values, making such transfers far too costly for migrant workers. Their only option is then to maintain their rights in their previous pension fund which may not adequately preserve the real value of the pension rights.

3.3 Improving the social protection of workers and facilitating their mobility: possible solutions

Cross-border membership?

3.3.1 Changing from one occupational pension scheme to another (or none at all) may, because of vesting and waiting periods, make it more difficult for a worker to acquire supplementary pension rights and will almost always result in the loss of a substantial part of the supplementary pension one can expect upon retirement. A first approach could therefore consist in avoiding, whenever this is possible, a change to a different pension scheme and the resultant losses in terms of social security rights. For cross-border migrant workers, this would imply *cross-border membership* in pension funds. However, cross-border membership of individual migrant workers will only be an option in a minority of cases. It requires the possibility to remain in the previous pension scheme, acceptance of the new employer to pay contributions to the employees previous scheme, tax deductibility of these contributions and,

finally, the absence, in both the present and previous countries of employment, of legal obstacles prohibiting membership in a foreign fund.

3.3.2 If the employment in another country is intended to be of short duration, then the possibility exists for a worker to remain covered, for up to one year[19], by the statutory social security schemes of his/her country of origin. Because of the complementarity of statutory and supplementary schemes, short-term migrant workers should also be given the possibility to remain in their previous supplementary scheme, if it could be expected that they would have to rejoin the same scheme after returning from their employment abroad. The tax rules of the country of employment should allow the tax deductibility of contributions paid into a pension scheme established in another country if this scheme enjoys the favourable tax status in its own country. It should be pointed out that the Commission has launched a certain number of infringement procedures against various Member States in order to ensure the tax deductibility of life insurance premiums paid to companies established in another Member State under the same conditions as for premiums paid to a domestic company.

3.3.3 The Commission services have recently put forward some ideas on cross-border membership of pension funds in a working paper issued towards the end of 1990. These would deal with the problem of at least one particular category of migrant workers, namely those who, during their career, are employed by different companies or subsidiaries belonging to the *same multinational group*. Particularly for these multinational groups, the working paper suggested to remove the obstacles preventing them from creating a single pension fund for all their employees in different countries. This would of course include a large majority of non-migrant workers as well as a minority of cross-border migrant workers.

3.3.4 Progress on this more general objective of cross-border membership is however complicated by the wide variety of pension arrangements throughout the Community and the importance of not undermining the social and political objectives which are pursued by these arrangements. Any directive on this subject will inevitably be limited in its scope by such considerations. In some respects these considerations may be of less importance in the case of individual migrant workers and it may be possible to make faster or more direct progress in this area. A Community-wide pension fund, whether for individuals or larger groups, would normally wish to provide different benefits depending on the country of employment and the scope of statutory

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[19] with the possibility of prolonging it for a further year; see article 14 of regulation 1408/71. Article 17 of the same regulation provides for even greater flexibility on the basis of bilateral agreements among Member States.

social security benefits in that country. It would also have to respect different legislative requirements.

Facilitating the acquisition of rights

3.3.5 Excessively long vesting and waiting periods can hinder labour mobility by linking an adequate pension level too strongly to long uninterrupted service periods with the same employer. Labour mobility can help to match demand and supply on the labour market. This is of particular importance for economies with an ageing workforce and small numbers of new entrants to the labour market who might easily be channelled into expanding sectors. Shorter vesting and waiting periods would also reduce a source of indirect discrimination against some categories of workers, most notably women workers, who are most likely to change jobs or interrupt their careers. Excessively long vesting and waiting periods may not even be in the interests of employers as their benefit promises will not be considered by workers as a good substitute for the direct wage and may let the overall compensation package appear uncompetitive. Comparisons between Member States of the Community show that voluntary pension schemes do exist and can be of considerable importance even if vesting and waiting periods are short or in the case of immediate vesting.

Protection of preserved rights

3.3.6 The principal long-term objective in the area of supplementary pension schemes should be to ensure that every scheme leaver is legally entitled to *maintain acquired rights* in a pension scheme until he/she retires. Such deferred benefits should be revalued, protecting them against erosion through price inflation.

A fair transfer option

3.3.7 The preservation of rights in a previous pension scheme should always be an available option, as transfers of capital values may not be possible for various reasons. The new employment may not offer the possibility of joining a pension scheme, or one of the schemes involved may, because of its financing method (pay-as-you-go or book reserves) or for fear of the technical difficulties involved with transfers, refuse to give or receive transfer payments. However, transfers may often be preferable, either because deferred benefits are less well protected against inflation (or do not rise in line with earnings) or because it may not be desirable to multiply the number of relatively small benefit entitlements and thereby raise administrative costs of pension schemes. If, however, the transfer option is available, then the scheme leaver should be given the choice between maintaining rights in the previous scheme or transferring them into the new scheme.

Better information

3.3.8 Members of supplementary pension schemes should be entitled to *full and regular information* on their supplementary pension rights. They should be enabled to appreciate the financial consequences, at the moment of their retirement, of a job change. They should be given full information on the transfer value they could expect, and on the amount of retirement benefits they would eventually receive if they decide to maintain their rights within their present scheme. The underlying assumptions concerning interest rates, inflation, earnings profile and revaluation of 'dormant' rights should be clearly spelt out. This information should be given to scheme members at regular intervals without workers having to request it and thereby possibly reveal their intention to quit.

Fair actuarial standards

3.3.9 If mobility from one Member State to another is to be promoted it would be necessary to ensure that *actuarial standards* applied to transfers do not represent an obstacle to this mobility. The assumptions used for calculating the (transferred or preserved) rights of a scheme leaver should not be less favourable than those used for determining whether a pension scheme is sufficiently funded.

Avoid double taxation

3.3.10 A solution has to be found to the problem of *taxes on transfer values* representing pension rights acquired within a previous pension scheme. This is particularly important for workers who must fear that their benefit rights are insufficiently preserved in the previous scheme. Whilst there should be safeguards that tax cannot be avoided completely by a mobile worker or pensioner, Member States should ensure that migrant worker be not subjected to any form of double taxation.

4. Conclusion

4.1 The Community should recognise the principle that each worker should be able to move to a job in another Member State *without having to fear any undue loss* of rights to future retirement benefits. How this is to be achieved can be left to a very large extent to each Member State or those persons or groups who design and run a supplementary scheme. Section 3.3 indicates the principal alternatives which are available in order to achieve this goal. Progress along these lines would facilitate labour mobility and thereby increase the performance of the labour market and hence the European economy as a whole. At the same time, the direct and indirect discrimination on grounds of sex has to be avoided and ways could be sought by which weaker groups of employees, such as part-timers and temporary workers, can be given access to supplementary schemes.

4.2 Supplementary pension schemes are a complex issue, involving many different players at different levels. For this reason, the Community could and should stimulate efforts at all levels, i.e. the Community, the Member States and the social partners, to remove obstacles to cross-border mobility.

4.3 The Commission will undertake efforts to obtain more and better information on supplementary pension schemes throughout the Community. Of particular interest will be the monitoring of evolutions at the national level and the assessment of the actual or potential impact of various Community measures (see above, 2.5.6 to 2.5.11) on supplementary pension schemes.

4.4 Finally, the Commission will also focus its attention on other forms of supplementary social protection where obstacles to mobility may exist. This is particularly likely to be the case with health insurance which will be the subject of a future communication, to be presented to the Council before the end of 1992.

APPENDIX:

Key characteristics of supplementary pension schemes in the Member States of the Community

INTRODUCTION

This appendix highlights the key characteristics of supplementary pension schemes in each of the Member States. It is by no means comprehensive, nor can the same type and quantity of information be provided for each country. The main purpose of this appendix is to illustrate the diversity of pension schemes and of the national regulatory frameworks in which they operate.

As a result, the information given in this appendix cannot be considered as a sufficient basis for concrete proposals with a view to improving the social protection of mobile workers. More information on specific problem areas, as they have been identified in the present communication, will have to be requested from experts working in government departments and in institutions connected with private retirement provision prior to the drafting of proposals for concrete improvements.

BELGIUM

The statutory pension scheme is designed to cover the entire active population, offering a relatively high level of earnings related retirement benefits.[20]

Supplementary schemes are usually set up at the initiative of the employer, although some industry-wide schemes based on collective agreements do exist and employee contributions are common.

Recent legislation (1985) outlawed book reserve plans and left a choice between group insurance and pension funds as financing vehicles for pension schemes. Pension funds are jointly managed by the two sides of industry. Employer contributions to group insurance plans are subject to a social security levy.

The Belgian government proposed in 1987 a bill on occupational pension schemes. One of the aims of this initiative was to facilitate the mobility of workers. However, so far no legislation has been adopted by the parliament.

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20 New estimates of income replacement ratios for statutory pension schemes in the Community are currently being worked out by EUROSTAT, the Statistical Office of the European Communities.

Contributions to supplementary pension schemes are tax deductible as long as they do not result in too high a replacement ratio. Investment income of pension funds is subject to a withholding tax. Income tax is due on benefits above a certain minimum.

DENMARK

The Danish statutory social security system provides a basic pension for all residents from the age of 67. In addition, persons in employment are covered by a mandatory contributory scheme the benefit level of which is only determined by the length of service and not by the level of earnings.

Although the statutory pension schemes leave considerable scope for supplementary schemes, less than half of the employees seem to be covered by such schemes. Recently an agreement has been reached on the establishment of industry-wide pension schemes which should be in place by 1993.

Employees do normally pay part of the total contributions to their pension schemes which tend to be of the 'defined contribution' type.

Contributions to pension schemes are normally tax deductible, provided some conditions are met. Benefits are subject to income tax. It is interesting to note that pension funds are subject to a tax on the real return on their capital.

GERMANY

Statutory social security provides earnings related pensions up to a fairly high income ceiling, leaving some scope for supplementary schemes especially in the case of well-paid workers.

Supplementary schemes are usually set up by employers for the benefit of their employees contributions of whom to the schemes are uncommon and in most cases even impossible (book reserve schemes).

The dominant type of financing technique are book reserves, although pension funds and direct life assurance also exist. The solvency of any not fully funded pension scheme has to be guarantee by a membership in the solvency insurance scheme 'Pensionssicherungsverein'.

Legislation on supplementary pension schemes exists since 1974 when a law for the improvement of occupational retirement provision was adopted, codifying recent rulings of the labour courts. The law introduced in particular (comparatively high) limits on vesting periods and an

obligation to adjust pensions in line with inflation or earnings.

Taxation depends on the financing vehicle chosen for a pension scheme. The tax burden falls on contributions, which are taxed as earned income at the hands of employees, in the case of insurance-type financing techniques and on benefits in the case of book reserve schemes and the so-called 'Unterstützungskassen' which do not create a legal entitlement to a pension. Investment income of the schemes is normally not taxed. Employee contributions, which are only possible in the insurance-type schemes, are tax deductible up to certain limits.

GREECE

Statutory pension schemes provide benefits calculated according to earnings and the length of contribution periods. For average workers with full careers the benefit level would not leave very much scope for supplementary schemes. It should, however, be pointed out that social security institutes are facing serious financial difficulties which may require a general overhaul of the system.

Supplementary benefits are provided by auxiliary funds usually set up for an industry or a profession. The largest of these schemes, TEAM, was created by the government and covers all employees affiliated with the largest social security institute, IKA, who are not members of another auxiliary fund.

Some multinational employers offer pension plans of a defined benefit type which are normally fully integrated with the compulsory schemes. Such voluntary private schemes appear to be largely unregulated by law and, in particular, no legal vesting requirements are imposed. Vesting of even of employer contributions is nevertheless becoming more common.

Contributions to supplementary pension schemes are normally tax-deductible, whilst benefits are taxed as earned income.

SPAIN

Statutory retirement benefits are earnings related and can be considered as generous as they tend to provide a high level of replacement income. Over the recent years, measures were adopted which tended to reduce the generosity of the system, namely by taking into account longer earnings records than was originally the case. The need for supplementary protection nevertheless remains limited.

Many large employers do have supplementary schemes which are often taken into account in collective agreements. Until

1987 there was little government regulation of supplementary schemes and even the 1987 law on pension plans and pension funds does not oblige pension schemes to conform to this legislation. Schemes set up under the 1987 law do, however, benefit from a more favourable tax status.

Up until now, it appears that fewer pension schemes than expected have applied for recognition under the 1987 law. This may be explained either by the stringency of the conditions, which include immediate vesting, full external funding, non-discriminatory coverage of all employees and a high degree of workers' participation. On the other hand, it might also be argued that tax incentives are not sufficient to compensate for the loss of freedom implied by the 1987 law.

Employer contributions are tax-deductible but they would be added to the taxable income of the employee in the case of schemes which do not comply with the 1987 law and in the case of contributions to recognised schemes in excess of a fixed amount. Benefits are taxable.

FRANCE

The statutory pension scheme provides earnings related benefits of up to 50% of average earnings during the ten years preceding age 60 or retirement. However, the ceiling of covered earnings can be considered as moderate. Thus there is significant scope for supplementary schemes.

Such schemes were created at the initiative of the social partners and then made mandatory for all employers by the government. Whilst there are many institutions managing supplementary pension schemes, they are organised in two large associations, AGIRC (for higher-ranking employees) and ARCCO (mainly for blue-collar workers). Within these associations, the conditions for the acquisition of benefit entitlements (contribution rates and eligibility conditions) are identical and financial compensation between institutions is organised accordingly. The mandatory nature of these supplementary schemes and the fact that they cover virtually all employees allow them to be safely financed on a pay-as-you-go basis.

Vesting is immediate and benefits are paid anywhere in the Community. Furthermore, although transfers are not normally done, preserved rights are well protected against inflation as members acquire 'points' the value of which is the same regardless of whether they were acquired 30 years ago or only last year. As a result, mobile workers are not in danger of losing pension rights.

In those cases in which normal benefits from the statutory and mandatory supplementary schemes are not considered as sufficient, additional voluntary contributions can be made to the AGIRC and ARCCO institutions. Alternatively,

retirement benefits can be topped up by insurance contracts.

Contributions to AGIRC and ARCCO are tax deductible up to a high ceiling. Benefits are taxed as earned income.

IRELAND

The statutory social security scheme offers benefits which are related to contribution periods but not to earnings. As a result, the majority of the workforce would require additional coverage. About 50% percent of employees are covered by supplementary schemes.

Supplementary schemes are typically set up and run by individual employers although they may be one of the issues negotiated with trade unions. It appears that employee contributions, although still uncommon, are becoming more frequent.

In 1990, a comprehensive new legislation on occupational pensions was adopted. The pensions act provides for vesting after a maximum of five years, offers a choice between transfers and benefit preservation to scheme leavers (in which case annual revaluations will have to be made) and gives scheme members the right to detailed information on their scheme and on their benefit entitlements. A pensions board was also created as a supervisory body.

Contributions, both by the employer and by the employee, to an approved scheme are tax deductible, as long as they do not exceed a given percentage of gross earnings. Benefits are subject to income tax.

ITALY

Statutory social security provides pensions related to earnings during the final five years of activity, not limited by an earnings ceiling. However, lower accrual rates apply to higher income levels, so that high earnings are less well covered than low earnings. Nevertheless, the scope for supplementary retirement provision remains extremely limited. This is also true because executives in industry and commerce are not covered by the general statutory scheme but by special 'dirigenti' schemes which are based on collective agreements.

As a result, supplementary retirement provision as in other Member States of the Community is rare in Italy. Such arrangements as do exist can be set up in a variety of different forms, as far as the type of benefits and the financing and management methods are concerned. A comprehensive legal framework is felt to be necessary and discussions are under way.

Contributions to compulsory pension schemes are tax

deductible. Employer contributions to other schemes can be considered as tax deductible expenses if certain conditions are met, namely that there must be a collective agreement and that it must be tun by a clearly defined separate legal entity ('cassa di Previdenza'). If a 'Cassa di Previdenza' is not used, contributions will be considered as taxable income of the employee. Benefits are subject to income tax.

LUXEMBOURG

Statutory social security provides earnings related retirement benefits subject to an earnings ceiling. Higher-paid employees will therefore require supplementary benefits in order to maintain there standard of living during retirement.

Many companies therefore have supplementary pension schemes, usually based on the book reserves financing method. Employee contributions are not common. There is no obligation to take out insurance against insolvency. Benefit promises are usually closely linked to statutory benefits. There is no legal vesting requirement although for tax reasons rights often become vested after five years of scheme membership.

Whilst employer contributions to occupational schemes are treated as tax deductible expenses, such contributions would be considered as taxable income of the employee if the scheme is pre-funded. Additions to book reserves, by contrast, are not included in the taxable income of the employee. Benefits are subject to income tax.

NETHERLANDS

Statutory retirement benefits are flat rate, amounting to 50% of the minimum wage for singles and 70% for couples. As a result, supplementary schemes are common and cover most employees.

Industry-wide schemes play an important role in the Dutch system. Such schemes can be created on the basis of a collective agreement and membership can then be made mandatory for all employees of a the sector, even if their employer does not belong to the employers' confederation. Employees do normally contribute to their employer's or industry's pension scheme which has to hold separate funds to guarantee that pension liabilities will be met.

Rights are fully vested after one year's scheme membership. Over recent years a very close cooperation amongst many pension funds has emerged with regard to transfers of pension rights. As a result of this voluntary arrangement, pension losses for job changers have been minimised.

Reasonable contributions to pension funds providing

annuities rather than lump sums are tax deductible and employer contributions are not considered as taxable income of the employee. Benefits are taxed on the basis of a special tax schedule for pensions.

PORTUGAL

Statutory pensions are related to the earnings during the best five years within a ten year period prior to retirement and benefits are confined to a range of 30 to 80% (for a full career) of the average earnings of these five years.

Occupational pension schemes are not very common, possibly as a result of the small average company size. However, some schemes had been created on the basis of collective agreements following the 1974 revolution. Many schemes are financed on a pay-as-you-go or book reserve basis although recent legislation gives tax advantages to funded schemes.

There is no legal vesting requirement and vesting is unusual. Some schemes offer incentives to employees for voluntary retirement.

Contributions to supplementary pension schemes are normally tax-deductible for employers and employees. Allocations to book reserves are not considered as tax-deductible expenses but benefits are. Benefits are subject to special, more favourable income tax rules.

UNITED KINGDOM

Statutory social security provides for a flat rate pension and an earnings related additional pension (SERPS). The combination of these two elements does nevertheless not normally yield a satisfactory replacement income. Supplementary schemes are therefore common. It is possible to contract out of SERPS provided the private (company or personal) scheme offers equivalent guarantees.

About 50% of the employees are covered by supplementary schemes which are typically set up by companies and are normally pre-funded, either through an insurance contract or a separate pension fund. Employee contributions are common.

Pension rights must vest after two years. Recent legislation has improved the situation of scheme leavers by making a limited revaluation of deferred pensions compulsory.

Provided a scheme is approved by tax authorities, contributions to it are tax deductible and are not considered as taxable income of the employee. Investment income of funds is tax exempt. Benefits are subject to income tax.