

Explanation and Promotion of a Reform to the Public: Riester-Pensions

(Room Document N°26, Session 7)

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Agenda

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Part 2 - Structure

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Part 5 - Obstacles

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Part 1 –

Riester-Pensions: Demographic Background

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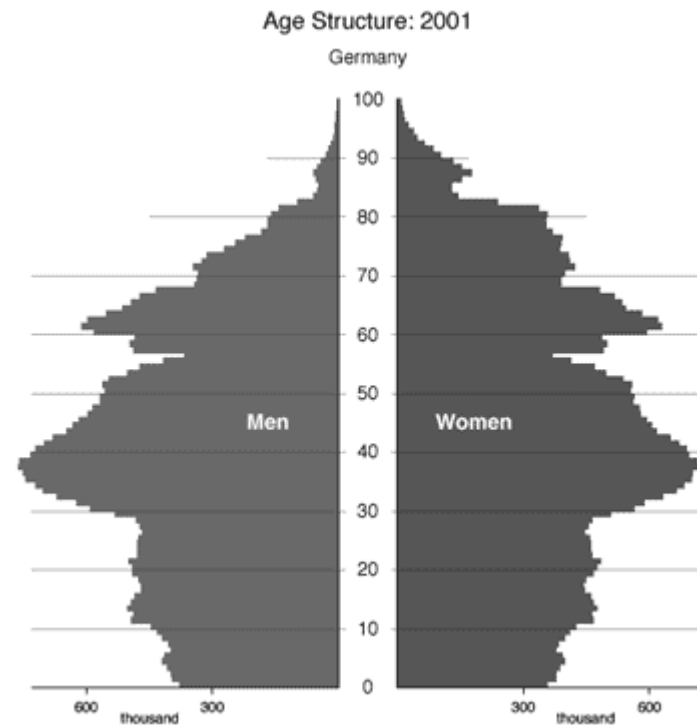
Germany's Population today

Population: 82,5 Million

Annual Birth Rate: 730.000

Old Age Ratio: 44

(100 at working age 20-59
to 44 at retirement age 60+)



Source : Federal Statistical Office Germany - 10th Population Projection, June 2003

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Germany's Population by 2050

10th Population Projection

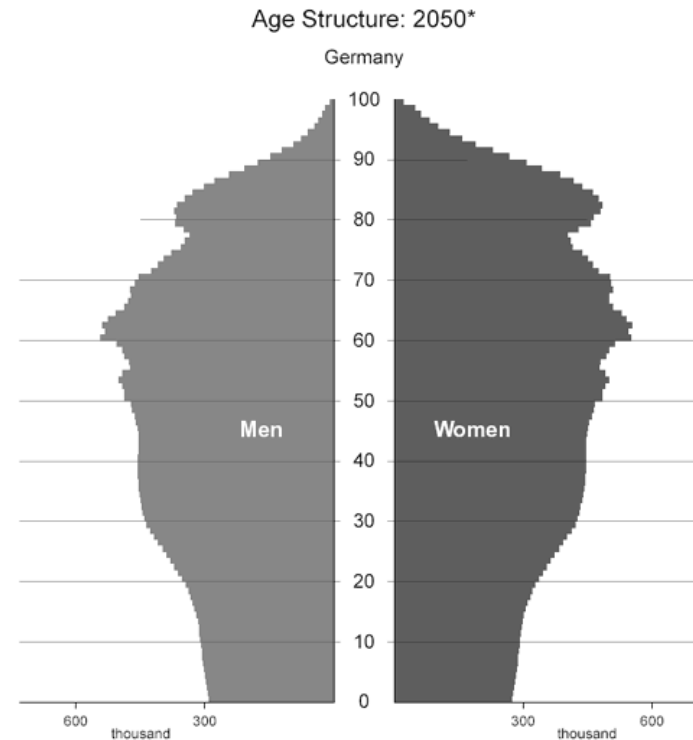
“Middle Variant”

Population: 75 Million

Annual Birth Rate: 560.000

Old Age Ratio: 78

(100 at working age 20-59
to 78 at retirement age 60+)



Source : Federal Statistical Office Germany - 10th Population Projection, June 2003

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Conclusion: Aging society

- Half of the population will be aged over 48 - one third 60 or older
- Life expectancy of a male increases to 81.1
- Life expectancy of a female increases to 86.6
- Raising retirement age to 65 years would still raise Old-Age Ratio to 55
- Population will drop to 1963 level by 2050
- Total labor force will fall from 41.6 Mio. (1995) to 32.6 Mio. in 2040
- Labor force aged 15 - 25 will fall by 33%
- Labor force aged 25 - 35 will fall by 44%
- Contribution to the current PAYG-system would raise to 24-26%

Source : Federal Statistical Office Germany - 10th Population Projection, June 2003 & Prognos Report 1998



Part 2 –

Riester-Pensions: Structure

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Who is Mr. Riester?



Walter Riester

Member of the *Bundestag*

Born 1943 in Kaufbeuren, Germany

Since 1966: Party member of the Social Democrats
(*Sozialdemokratische Partei Deutschlands
SPD*)

1977-1993: Labour Union

1993-1998: Chairman of the Labour Union Metal
(*Industriegewerkschaft Metall IGM*)

1998-2002: Federal Minister for Labour and Social
Affairs (*Bundesminister für Arbeit und
Sozialordnung*)

Seit 2002: Member of the German Parliament
(*Mitglied des Deutschen Bundestages MdB*)

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2001 Pension reform

Goal:

- To reform the PAYG pension-system
- To introduce 2nd pillar pensions
- To support 3rd pillar pensions

Approach:

1. Retirement Savings Supplementary Law (*Altersvermögensergänzungsgesetz - AVmEG*)
2. Retirement Savings Law (*Altersvermögensgesetz - AVmG*)
3. Rules on Pension Fund solvency, minimum funding and investment rules
4. Amendment of the Civil Service Pensions Law (*Versorgungsänderungsgesetz*) to include the civil service under the reform

Source : Verband Deutscher Rentenversicherungsträger (VDR) 2001

The core-concept

Retirement Savings Law (*Altersvermögensgesetz - AVmG*)

- “Riester-Scheme” for supplementary pension provisions
- Measures to strengthen occupational pensions
- Introduction of pension funds in Germany

Focus 1 : Individual pensions

Supplementary Private and Funded Products –

- *Right:* Income-tax deduction and subsidies
- *Requirement:* Contract-scheme that complies with the “Riester”-Conditions (*Altersvorsorgevertrag*)
- *Scope:* 2nd. and 3rd. pillar pension schemes

Source : Altersvermögensgesetz - AVmG 2001

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„Riester“ Conditions (*Altersvorsorgeverträge*)

Individual pension plans have to include:

- *Withdrawals:* Not before 60
- *Benefits phase:* Lifelong annuity or disbursement plan combined with lifelong annuity from the age of 85
- *Benefits:* Minimum guarantee
- *Contracting fees:* Must be spread equally over at least 10 years
- *Documentation:* Extensive administrative and transparency requirements

Focus 2: Occupational pensions

Measures to strengthen occupational pensions –

- *Claim:* Law on occupational Pensions (*Gesetz zur Verbesserung der betrieblichen Altersversorgung - BetrAVG*) introduces a right of the employee to claim conversion of wages to a occupational pension
- *Right:* If a occupational pension scheme does not exist or cannot be established with the employer, the employee has the right to demand the conclusion of a direct-insurance contract (3rd. pillar)
- *Transfer:* Improved right of transfer of established schemes to a new employer

Source : Altersvermögensgesetz - AVmG 2001

Eligible Vehicles

Occupational pensions

- *Pensionskassen*, Insurance Company or Pension Funds
- Specific Condition: Payment of benefits in line with “Riester”-Scheme

Individual pension plans

- Life Assurance contract, bank account, savings account with insurance companies, shares in mutual funds
- Pension contract (*Altersvorsorgevertrag*) in line with “Riester”-Scheme

Source : Altersvermögensgesetz - AVmG 2001



Part 3 –

Riester-Pensions: Incentives

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Incentives - Overview

Law on Income Tax (*Einkommenssteuergesetz - EStG*)

- Tax deduction of “Riester”-Scheme contributions (*Sonderausgabenabzug*)
- Subsidies (*Altersvorsorgezulage*)
- Incentives for families
- Growing stimulation over a period of 6 years
- Specific incentives for certain groups of individuals (Farmers, unemployed etc.)

Incentive 1: Deductible contributions

§10a Law on Income Tax (*Einkommenssteuergesetz - EStG*)

- Individual must be insured in the PAYG mandatory insurance
- Must be income eligible for mandatory PAYG contributions
- Maximum deduction equals PAYG contribution ceiling (*Beitragsbemessungsgrenze*)
- Phased deduction (2002 – 2008 and later)

Source : Einkommenssteuergesetz - EStG

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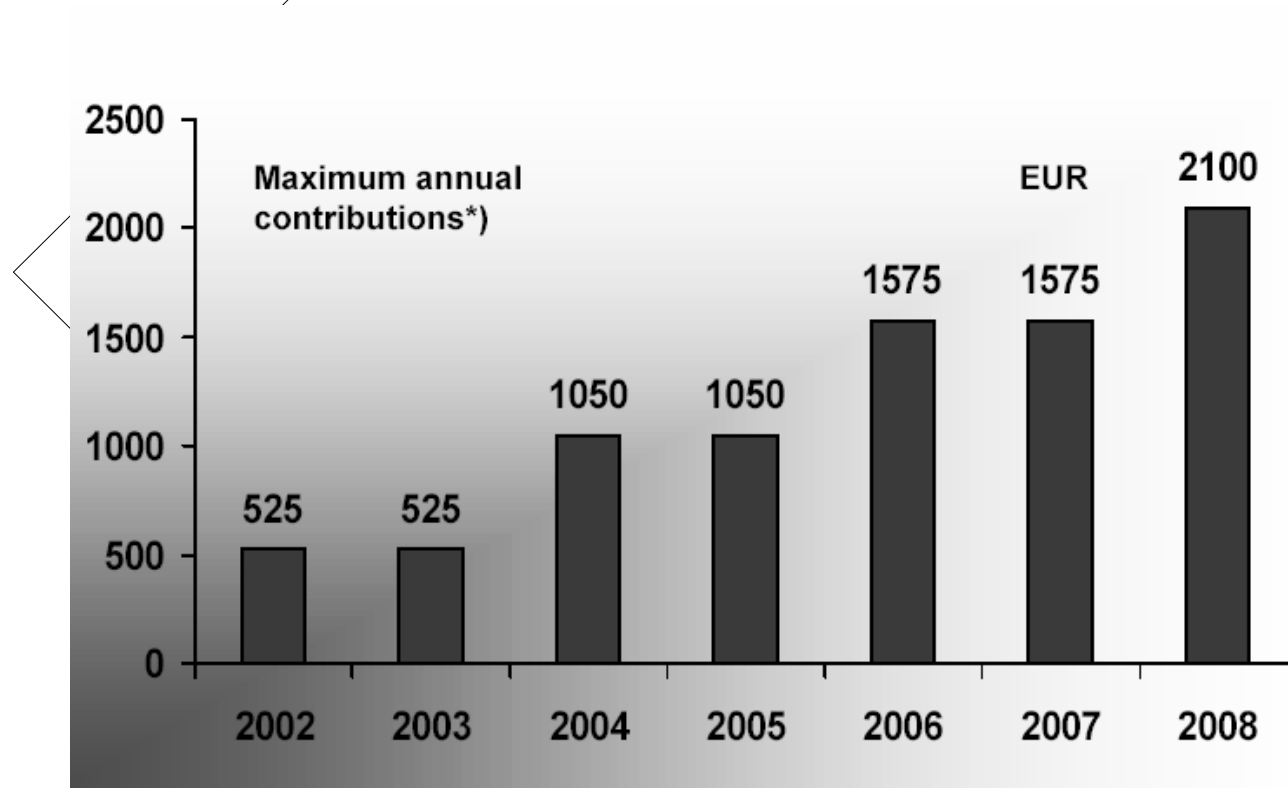
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Incentive 1: Deductible contributions (Graphic)



Source : Dr. Michael Wolgast - GDV

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Incentive 2: Subsidies (*Altersvorsorgezulage*)

§§79-86 Law on Income Tax (*Einkommenssteuergesetz - EStG*)

- Any person eligible for deduction as per §10a EStG
- Contributions must be paid for a “Riester”-Scheme contract
- Certified contract in line with the “Retirement Saving-Contracts Certification Law” (*Altersvorsorgeverträge-Zertifizierungsgesetz AltZertG*)
- Certain contributions are excluded
- Minimum contribution required (1-4% of the PAYG qualified income)
- Phased basic subsidies
- Extra subsidies for families and low income-groups

Source : Einkommenssteuergesetz - EStG

Incentive 2: Subsidies (Graphic)



Source : Dr. Michael Wolgast - GDV

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Part 4 –

Riester-Pensions: Current Status

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Status of individual private pensions

- 3 Million contracts signed
- Average total contribution in 2002 has been 175 Mill. €
- Total volume is 886 Mill. €:
- 522 Mill. € private contributions and 360 Mill. € subsidies
- Approximately another 3 Million individuals wait
- 300.000 contracts have been cancelled

Source : Prof. R. Schnabel „Die geförderte private Altersvorsorge – Flop oder Top?“ DIA 2003

Status of occupational pensions

- 2 Million contracts signed
- Average total contribution in 2002 has also been 175 Mill. €
- Total volume is 589 Mill. €:
- 349 Mill. € private contributions and 240 Mill. € subsidies
- Many employers still do not offer pension-schemes
- Growth in 2002 significantly higher than individual schemes

Source : Prof. R. Schnabel „Die geförderte private Altersvorsorge – Flop oder Top?“ DIA 2003

Public reception: General remarks

- Public reliability-estimation of the German PAYG pensions is low
- Public estimation of private and funded schemes is stable,
- however could not overcome public insecurity on the issue
- 22% of interviewed persons did not conclude private contracts
- Public estimation on pension security has dropped to 47%
- Public continues to ignore the issue of 2nd. pillar schemes

Source : DIA (Deutsches Institut für Altersvorsorge) Pension Barometer June 2003

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Public reception: Outlook

- Number of individuals ignoring „Riester“-pensions has risen to 70%
- Number of waiting but willing individuals has dropped slightly
- Number of conclusions has dropped 0,5% in June 2003
- Only 15% of the population between 18-65 choose a “Riester”-pension
- 4% state that they have tried a scheme, but refrained from it

Source : DIA (Deutsches Institut für Altersvorsorge) Pension Barometer June 2003

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Part 5 –

Riester-Pensions: Obstacles

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Crucial acceptance factors

- Solvency of private households
- Profitability of tax deductions and subsidies offered
- Transparency of “Riester”-Schemes
- Do “Riester”- schemes fit to employee’s preferences?
- Flexibility “Riester” – schemes
- Psychology and reputation of “Riester” - schemes

Problem 1: Labour market

- Soldiers, students, pupils and other groups do not fit
- Unemployed and non-working population do not fit
- Individuals close to pension-age and pensioners do not have incentives
- Better options than occupational pension-schemes (*Entgeltumwandlung*)
- Free-lance individuals are not included (exception: spouse PAYG)
- Civil service employees were included in parallel scheme in 2002 only

Problem 2: Complexity and transparency

- Too many limitations and exclusions
- Contribution-level is difficult to calculate
- High level of consultancy required
- The width of eligible products produces insecurities
- Rules on combination of incentives and vehicles are complicated
- Application for subsidies is too complex

Problem 3: Flexibility and information

- Prerequisites of “Riester”-schemes fall behind other funded products
- Accumulated assets are not accessible in the beginning
- Most of the pension is fixed in a life-long annuity
- Relocation abroad calls for full return of subsidies
- High administrative costs
- In 2002 only 50% of employees knew of incentives
- 11% of the population does not know if they are eligible (*DIA-Data*)
- Only 45% believe to be eligible (*DIA-Data*)

Source : Bertelsmannn “Vorsorgereport” 2002

Problem 4: Labour market reform

- “Hartz IV”-reform law intends to force unemployed to use savings
- Law intends to lower allowance from 520 € to 200 € for unemployed
- Would come into force on 1. January 2004
- Existing 3rd. pillar contracts may have to be cancelled
- German insurance industry calls to drop this intention

Source : Gesamtverband der Deutschen Versicherungswirtschaft – GDV Press Release August 2003

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Part 6 –

Riester-Pensions: Conclusions

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Conclusions

- PAYG mandatory contributions rise in 2003: A clear setback
- Current saving-rate does not suffice: Growing pension-gap
- “Riester”-pension has not changed the German financial sector
- “Riester”-pension still may be a nucleus for the 2nd. Pillar
- Pension through funded schemes needs more promotion
- Need for system-change has not been fully understood