Explanation and Promotion of a Reform to the Public: Riester-Pensions
(Room Document N°26, Session 7)

by Attorney at Law Markus Weyer (Köln, Germany)

OECD Conference on Pension Reform in Russia, Moscow

MJW

Agenda

Part 1 - Demographic Background

Part 2 - Structure

Part 3 - Incentives

Part 4 - Current Status

Part 5 - Obstacles

Part 6 - Conclusions
Part 1 –

Riester-Pensions: Demographic Background
Germanys 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+)

Germanys 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+)

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%

Part 2 –

Riester-Pensions: Structure
Who is Mr. Riester?

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)

Walter Riester
Member of the Bundestag

MJW
www.mjw-de.com

Copyright 2003 © Attorney Markus J. Weyer
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*
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
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
Incentive 1: Deductible contributions (Graphic)

Source: Dr. Michael Wolgast - GDV
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
Part 4 –

Riester-Pensions: Current Status
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
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
Part 5 –

Riester-Pensions: Obstacles
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: Bertelsmann “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

Part 6 –

Riester-Pensions: Conclusions
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