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**DEFINED CONTRIBUTION  
ARRANGEMENTS  
IN EUROPE**

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# Defined contribution arrangements in Europe

The main Report contains the following Sections

<b>Section</b>	<b>Page</b>
1 Introduction	1
2 Summary	1
3 Austria	2
4 Belgium	4
5 Denmark	6
6 Finland	8
7 France	9
8 Germany	11
9 Greece	14
10 Ireland	15
11 Italy	17
12 Luxembourg	18
13 Netherlands	19
14 Norway*	21
15 Portugal	24
16 Spain	25
17 Sweden	27
18 Switzerland*	29
19 United Kingdom	30

\* Not in the European Union

# Introduction

## 1

- 1.1 The purpose of this report is to summarise the form and structure of defined contribution retirement benefit arrangements within Europe. The intention is to focus on occupational retirement benefit programmes, although reference will be made to private provision. The term 'second pillar' is used to mean occupational pension arrangements whilst 'third pillar' refers to privately transacted arrangements.
- 1.2 The last decade has seen a greatly increased interest in defined contribution arrangements, although the detail of what represents a defined contribution arrangement can differ between different countries.
- 1.3 The information in this report was provided by the Pensions Committee of the Groupe Consultatif.

## Summary

## 2

- 2.1 Traditionally the most common form for occupational retirement benefits across Europe has been the defined benefit scheme. Over the past decade there has been an increasing interest among employers in defined contribution arrangements. The primary driver behind this trend have been the desire from employers to seek a greater stability of costs from year to year and the increasing complexity of the legislation and supervision of defined benefit arrangements.
- 2.2 The only country where defined contribution arrangements dominate occupational pensions is Denmark. Defined contribution plans are also common in Switzerland.
- 2.3 Defined contribution arrangements have reached a significant proportion of company pension arrangements in the UK for smaller employers, with the use of unit-linked insurance products being prevalent. Many larger employers in the UK have now closed their defined benefit plans and provide defined contribution plans for new employees.
- 2.4 In most other countries defined contribution arrangements are still very much in the minority but are becoming increasingly popular, particularly with multinational employers and for new arrangements for new employees.
- 2.5 In many cases the new defined contribution arrangements are funded through traditional insurance with-profit endowment insurance products with an interest rate guarantee. In some countries such as Italy, changes to the legislation has enabled pure defined contribution arrangements without guarantees to be introduced.

# Austria

## 3

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 3.1 Complementary occupational pension plans were in the past not particularly widespread in Austria, as the Austrian social security system provides generous benefits. This means that supplementary benefits tend to be provided only for individuals in high salary brackets ie above the earnings limit for social security (EUR 45,780 in 2002). Where additional benefits are provided, they have tended to be defined benefit and linked to final salary rather than of a defined contribution nature.
- 3.2 In 1990, the Pension Fund Act was introduced. The Act defined the framework for single employer or multi-employer Pensionskassen (pension funds). The benefit structure of a Pensionskassen can be either defined benefit or defined contribution. Since 1995, most of the new arrangements established through Pensionskassen have been on a defined contribution basis. Occasionally, defined contribution plans are financed through book reserves or direct insurance.
- 3.3 Some defined benefit plans funded through a Pensionskassen are called "defined contribution plans with additional payment". They tend to be found where a defined benefit plan was financed by building up book reserves and has been transferred to a Pensionskassen contract. The balance of the cost of such plans has to be met by the employer if necessary.
- 3.4 Contribution rates are normally specified as a percentage of salary, usually with a lower contribution rate applying to earnings up to the social security ceiling (up to 5%) and a higher contribution rate on earnings above the ceiling (10% - 15%). Some plans use a fixed rate for all employees.

#### *Third Pillar*

- 3.5 Some employees make additional voluntary contributions to the state pension scheme. Tax-deductible contributions are allowable up to a maximum of EUR 2,920 for an individual (doubled for a married couple) (2002) but only a maximum of 25% of the contribution will be tax-deductible. These contributions purchase a fixed amount of additional pension, regardless of the individual's age. Additional it is possible to sign a special contract under the income law (§108a) for which the contributions are not tax deductible, but up to EUR 1,000 p.a. there will be a bonus which is 9,5% (2003) to be repayed from state.
- 3.6 Insurance contracts can also be used to provide additional retirement income. In the overwhelming majority of cases these are set up as endowment insurance contracts with the possibility to purchase a pension at retirement.
- 3.7 There are new special investment saving funds that have been established for private pension savings. They are called "Pensions Investment fond" but not so popular. Additional there is a new insurance pension product – contract under the income law (§108g) for which the contributions are not tax deductible, but up to EUR 1,831 p.a. (2003) there will be a bonus which is 9,5% (2003) to be repayed from state.

### **Legal/tax framework**

- 3.8 Company pension funds in Austria are influenced by two federal laws, the Company Pensions Act 1990 ("BPG"), and the Pension Fund Act 1990 ("PKG").

- 3.9 The law allows employers to pay tax-deductible contributions to finance pension plans or to build up book reserves within certain limits. The limit contributions from an employer to Pensionskassen is 10% of salary so there will be no taxation on the employee side. Contributions above these limits made by the employer to a Pensionskasse are tax-deductible for the employer, but represent a taxable benefit-in-kind for the employee. The maximum tax efficient contribution to a direct insurance arrangement is EUR 300 per year. Contributions above this amount are tax-deductible for the employer but represent a taxable benefit-in-kind for the employee. The maximum contribution to a book reserve is calculated in accordance with specified actuarial methods set out in the Austrian tax code.
- 3.10 An employee can also contribute to a Pensionskasse, but these contributions are limited with EUR 1.000 or - if higher - with the level of contribution made by the employer.
- 3.11 Employee contributions under second pillar arrangements to either Pensionskassen or direct insurance are partially tax-deductible in accordance with the requirements mentioned in Section 3.5 above.
- 3.12 A Pensionskassen must take the legal form of a joint stock company. There are specific minimum requirements on the amount of paid up share capital and the ratio of equity to technical reserves etc. These requirements differ for überbetriebliche Pensionskassen (multi employer pensionfond) and betriebliche Pensionskassen (single employer pensionfond). There is a new change in the law therefore each Pensionskasse should build up a special reserve for the "Mindestertrag" (minimum interest rate) and that should be within 10 years 3% of the premium reserves.

#### **Product structure and providers**

- 3.13 A Pensionskasse must hold a separate account in respect of each individual beneficiary. The amounts financed by the employer and the employee are recorded separately.
- 3.14 The assets of the Pensionskassen must be held with a local deposit administration bank licensed to trade in securities. There are limits on what assets can be held, in particular not less than 40% of the assets can be held in local bonds.
- 3.15 The investment are held in separate funds for large employers or groups of smaller employers ("VRGs"). The mortality risk and investment experience is spread across the members of each VRG.
- 3.16 The stockholders of "überbetriebliche Pensionskassen" (multi employer pensionfond) are mainly insurance companies and banks. But more and more "betriebliche Pensionskassen" (single employer pensionfond) were founded.

#### **The role of the actuary**

- 3.17 The actuary for a Defined Contribution Pension Schemes (as well as actuaries in Defined Benefit Schemes) had to handle all actuarial matters and had to build up the actuarial balance sheet. But there are no special actions to be done.
- 3.18 The proofing actuary (Prüfaktuar) had to proof the balance sheet, the fulfilling of the future benefit, to look if there are changes in the business plan necessary, to provide the supervisory authority with necessary illustrations and reports. The Austrian Actuarial Association has provided a recommended practice guidance note which sets out the considerations an actuary needs to take account of when producing these illustrations and the minimum requirements of the actuarial report.

# Belgium

## 4

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 4.1 Although defined benefits plans still predominate, there has been a trend towards defined contribution arrangements particularly in respect of additional benefits for specific categories of employees.
- 4.2 More and more companies - even those which have applied traditional defined benefit arrangements for many years - increasingly explore the possibility to replace their defined benefit plan, possibly only for new employees. Or, they introduce a defined contribution component, therefore turning their defined benefit plan effectively into a hybrid plan. Moreover, it is generally expected that the new law on occupational pensions will lead to an increased prevalence of defined contribution plans, not in the least through the introduction of new industry-wide arrangements which are likely to adopt the defined contribution approach. This new law on occupational pensions (known as the Vendenbroucke law) has become effective on January 1, 2004.

Defined contribution arrangements normally include employee contributions. It is rather typical to apply a lower (employee + employer) contribution rate on earnings up to an earnings breakpoint and a higher rate above the breakpoint, although flat rate contributions are not uncommon either. The earnings breakpoint is usually equal or close to the Social Security ceiling (EUR 40,898.30 p.a. in 2004).

For such "step-rate" contributions, the contribution rate on the lower earnings part often lies between 2% and 6%, with the employee's share ranging from 0% to 2%. The contribution rate on the upper earnings part in many cases ranges from 10% to 20%, with the underlying employee's share ranging from 4% to 8%. The new law on occupational pensions will allow employers to apply increasing, age-related contribution rates insofar as the annual increment does not exceed 4% p.a.

- 4.3 Defined contribution arrangements have often been used to top up benefits for senior employees, high level managers and self-employed directors or as (tax effective) deferred compensation arrangements.

#### *Third Pillar*

- 4.4 Insurance contracts are widely used to provide additional retirement income. In the overwhelming majority of cases these are set up as capital insurance contracts on a traditional with-profit endowment basis.

### **Legal/tax framework**

- 4.5 The Banking, Finance and Insurance Commission ("C.B.F.A.") exercises control over both insurance companies and pension funds. The key regulations for group insurance are included in the Royal Decree of 14 November 2003. Another Royal Decree issued on the same date (14 November 2003) governs private pension funds in Belgium and a third one also relating to pension funds is still expected. Those new decrees replace/will replace the ones that were applicable till 2003. Moreover, the new legislation also overrides the provisions of the so-called Colla Law of 6 April 1995 which related to benefits provided by company pension plans whether secured through pension funds or insurance contracts.

- 4.6 Employer contributions to a pension fund/group insurance arrangement are tax deductible for the employer provided that state pensions and complementary, employer initiated, schemes do not exceed 80% of the last salary for a full career, pro-rated for service spent with the employer (the so-called 80% rule).
- 4.7 There is a special formula to calculate whether a defined contribution plan is within the 80% limit. Employer contributions are not considered a taxable income to the employees.
- 4.8 Employee contributions to a second pillar plan are tax deductible, again, provided the 80% limit is observed for both employee and employer contributions.
- 4.9 Employee contributions to a third pillar private arrangement can receive a tax credit up to the lesser of EUR 1,830 p.a. or 15% of taxable income up to EUR 1,520 plus 6% of other taxable income (2004).
- 4.10 Benefits are normally taken as a lump sum because of more favourable tax treatment that was applicable to lump sums and not to pensions. The new legislation has harmonised the tax treatment applicable to all benefits, irrespective of their delivery mode (lump sums or pensions), by extending the treatment of lump sums also to pensions. All contributions to group insurance arrangements and self-administered pension funds are subject to a 4.4% insurance tax. Employer contributions are subject to an 8.86% social security charge.
- 4.11 The assets of a self-administered pension fund are subject to an annual tax of 0.17%. Withholding taxes are also applied on dividends and income from investments.

#### **Product structure and providers**

- 4.12 Defined contribution arrangements are funded through (group) insurance contracts or through self-administered pension funds. Group insurance is currently the more prevalent vehicle and this has mainly to do with the fact that, today, defined contribution arrangements are predominantly applied by small and middle-sized organizations.

If the arrangement is fully insured, most often, standard group insurance (the so-called Branch 21 insurance), is applied, i.e. with individually allocated insurance accounts which accrue on the basis of a guaranteed investment return of currently 3.25% p.a. and insurance dividends. Alternatively, Branch 23 insurance can be applied, i.e. unit-linked insurance which normally does not provide any interest guarantee. This poses a potential problem in light of the requirements of the expected new law on occupational pensions which will require that contributions to defined contribution plans attract a guaranteed return of currently at least 3.25% p.a. for the employer contributions and 3.75% for the employee contributions. The same issue will arise of course for defined contribution arrangements funded through self-administered pension funds.

#### **The role of the actuary**

- 4.13 Prior to the implementation of the new law on occupational pensions, i.e. when defined contribution driven company plans were not required to deliver a minimum return (on employer contributions), the assets and liabilities did automatically match and were equal to the accrued contributions plus investment return. Going forward, defined contribution plans will be required to certify that obligations introduced by the new law are met.

# Denmark

## 5

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 5.1 Second Pillar arrangements are very common in Denmark, either as industry-wide schemes or through company sponsored arrangements. Almost all schemes are on a defined contribution basis.
- 5.2 Many of the industry-wide schemes have been established within the last 10 years. Contributions often started at 0.9% of salary and has increased over time to 9% or more. In many of the older schemes, contributions are higher at 15% of the salary. Employee contributions are common, typically at  $\frac{1}{3}$  of the total contribution.
- 5.3 Some arrangements are funded through a pension fund or "Pensionskassen", although the number of such funds has been in decline. In recent years, insurance arrangements have become the most popular method of funding for pension benefits.
- 5.4 Schemes funded through a pension fund tend to provide retirement pensions, disability pensions, spouse pension and children's pension and in some cases lump sum benefits. Life assurance arrangements normally provide annuities or lump sums or a combination of both.

#### *Third Pillar*

- 5.5 Third Pillar arrangements are established with life assurance companies as private pension schemes. One of the most popular arrangements is a capital pension scheme, where a lump sum is paid out at a date, defined by the insured person, between age 60 and 70.

### **Legal/tax framework**

- 5.6 Contributions made to an occupational pension scheme by an employee are deductible from taxable income. Employer's contributions are also tax deductible. Payments into private schemes are tax deductible at the top income band (marginal rate), but from 1999 contributions into capital pension schemes are only deductible at the middle income band (average rate).
- 5.7 Pension benefits paid out are taxed as personal income. Tax on lump sum payments from a pension scheme is levied at the rate of 40%.
- 5.8 Occupational pension schemes require the employee to pay Labour Market Contributions (gross tax). This contribution/tax is 8% of pension contributions. The employer pays the total pension contributions to the insurance company or pension fund, and the insurance company or pension fund then has to withdraw the gross tax and pay it to the Taxation Authorities.
- 5.9 The Danish "Real Interest Taxation Law" was from January 2000 replaced by "The Taxation of Pension Investment Returns Act". The tax liability is imposed on the life insurance companies and pension funds. The tax is with a few exceptions applied to all pension investment returns. The Computation is based on an inventory principle, and the tax rate is from 2001 fixed to 15%.



### **Product type/structure**

- 5.10 Unit-linked products are only a smaller, but growing part of the total market. The majority of arrangements are financed through with-profit deferred annuity contracts or pension funds. Under with-profit insurance contracts any surplus is paid back to the employer or employees as a reversionary bonus.
- 5.11 The products are based on a minimum guaranteed interest rate. This minimum interest rate is determined according to the Third EU Life Directive, and because of the real interest tax in 1999, the rate was fixed to 1.5% pa, which is still the current rate. For contracts or pension schemes established with life assurance companies before July 1994 the interest rate is usually 4.5% and for contracts and schemes established between July 1994 and July 1999, the interest rates is usually 2.5%. In pension schemes established before January 1996 with pension funds, the interest rate is usually between 4% and 4.5% but lower interest rates can be found.

### **The role of the actuary**

- 5.12 There are two types of pension funds with very similar legislation, company pension funds and lateral pension funds (nationwide, occupational pension funds). Both types are required to have an actuarial valuation each year, in company pension funds by the approved actuary and in lateral pension funds by the appointed actuary. The actuary's focus is on the liabilities which are calculated at market value. That means that mortality and disability rates and costs are set as realistic as possible, while the discount interest rate is calculated and published daily by the Danish FSA, based upon a specified selection of government bonds.

# Finland

## 6

### *Second Pillar*

- 6.1 The supplementary occupational pension arrangements are not very common in Finland due to the wide coverage of statutory employment pension schemes. Such arrangements are defined benefit plans which aim to top up the benefits provided by statutory schemes. Both pension funds and group insurance contracts are used.

### *Third Pillar*

- 6.2 Life insurance contracts are mainly used as private pension arrangements by individual persons. These contracts are usually of defined contribution type. Employers use life insurance contracts mainly to set up individual pension arrangements for i.e. executives of the company. Both defined benefit and defined contribution plans are used.

### **Legal tax framework**

- 6.3 Employer's and employees' contributions to supplementary occupational pension scheme are tax-deductible when the benefits of the scheme are within certain limits (the retirement age not lower than 55 years and the supplementary pension together with statutory pensions 66 % of the last salary at maximum). Contributions to individual pension arrangement are tax-deductible according to same kind of rules with addition of a maximum amount. The pension benefits are taxed as income.

### **Product structure and providers**

- 6.4 Covered above.

### **The role of the actuary**

- 6.5 There are no additional requirements for actuarial work.

# France

## 7

### **The role of defined contribution arrangements**

7.1 In France a significant pension reform has been introduced in August 2003 by the “Loi Fillon” with a main objective of equity between all working populations: employees of the private sector, civil servants and self-employed.

7.2 This Law introduces two new pensions vehicles which fall under insurance regulation and with income tax and social charges incentives:

- PERCO (initially named PPESVR in the Law and part of the second pillar): is a French Savings-Retirement Plan whose benefit is only paid as an annuity. This plan operates on a voluntary basis both for the employer and for the employees and within the frame of complementary savings-retirement plans implemented by companies for their employees
- PERP (initially named PEIR in the Law): is an individual savings-retirement plan.

#### *Second Pillar*

7.3 In France the combined social security and “repartition” nation wide ARRCO and AGIRC compulsory plans provide generous benefits to the bulk of the salaried employees meaning that company sponsored supplementary plans are not common. Where such plans do exist they are typically on a defined contribution basis (referred to as Article 83 - of the Tax Code -) for employees with an annual salary under 240,000 Euros since with that level of annual salary you can implement a vested DC plan within annual fiscal and social limits. Benefits payable from an Article 83 plan must be paid as a pension with different kind of contracts: savings account in Euros or in unit trust with conversion in life annuity at retirement (Lump sum payments are subject to restrictive provisions), deferred annuity or point schemes.

7.4 It is the first time employees of the private sector who have opportunities to get a significant tax relief through an individual voluntary retirement contribution (with possibility of a company match for PERCO). Before the “Loi Fillon” only contributions to compulsory collective schemes were tax deductible (within limits).

#### *Third Pillar*

7.5 Life insurance contracts are widely used to top-up employees mandatory retirement schemes. Favoured company savings plans are increasingly being provided by employers for employees. Though PERP can be offered through collective plans, everyone in France will have an individual access to PERP “open plans”, which represent now a tax effective alternative to traditional life insurance contracts.

### **Legal tax framework for defined contribution arrangements**

7.6 Before the Loi Fillon for employees of the private sector only mandatory collective DC schemes benefited from fiscal tax relief set in the Article 83 of the Tax Code . Since the Loi Fillon, in addition to Article 83 tax deductions, Article 163 of the Tax Code covers also voluntary collective DC or money purchase schemes and individual “open vehicles”.

7.7 Therefore the supplementary defined contribution retirement plans (to social security and ARRCO and AGIRC schemes) now include in addition to mandatory company sponsored collective plans (article 83 of the Tax code) PERCO and PERP plans as well.

- 7.8 The new pension reform has set the new legal framework for retirement defined contributions : an annual tax deduction of 10% of the net income ( before income tax).
- 7.9 Employee and employer contributions to supplementary defined contribution retirement plans and company match of the PERCO are taken into consideration. Should in a given year the annual amount of tax deduction not fully used by an individual, the balance can be carry forward on a three year rolling basis.
- 7.10 The PERP contracts are available to anyone with the same level of income tax deduction taking into consideration all contributions and company matching within company schemes (DC mandatory pension schemes, PERCO and any company matching except for PEE savings plan).
- 7.11 In all cases described above, the bulk of the benefits must be paid as an annuity to benefit from the tax relief. In addition to the fiscal rule the Social security rule is to be issued: i.e. an annual Social security ceiling will be set and the employer's contributions paid in excess to this annual limit will be subject to social security contributions.

### **Product structure and providers**

- 7.12 Under a defined contribution Article 83 pension plan, a typical practice is to set the contribution as a fixed percentage of all or part of the salary with the contribution often differentiated between different levels of salary or employee status e.g. it is common to pay a higher rate of contribution on higher layers of income to compensate the fact that the retirement replacement ratio decreases when the salary increases. Article 83 DC plans must be arranged only through group insurance contract with an insurance company. Contributions are paid into an individual account allocated to each employee. The individual account is either awarded with interest under a capitalisation system with a "with profit" system according to a defined interest rate or by the income earned on the investments as stipulated in the contract conditions. Contributions can also be used to purchase units in investment funds whereby the holding of each employee in respect of each employee will then reflect the value of those investment fund units.

### *New Developments*

- 7.13 Insurers are developing PERP and PERCO plans.
- 7.14 The PERCO and PERP plans are contracts called "Plan d'épargne retraite" which must be subscribed by associations (groupement d'épargne retraite populaire) whose operating rules are defined by decree. Moreover each plan is under the supervision of a Supervisory board (conseil de surveillance).
- 7.15 All the aspects of assets management are also subject to regulation. One important feature is to cap investments into sponsor plan company shares to 5% of fund assets.
- 7.16 The PERCO and PERP schemes may have different forms: saving plans in Euros with transformation in life annuity at retirement or deferred annuity or points system with a link between the acquiring price of the point and the point value to assess the pension. The contract may cover biometric risks.

### **The role of the actuary**

- 7.17 The French system operates within an insurance regulation framework, and the contracts/products are elaborated by actuaries. The supervisory board of the "Plan d'épargne retraite" may ask actuaries for advice or annual reports. An actuarial report must be provided at least each five years by an actuary entitled by an actuarial association recognised by the Insurance supervisory authority. Nevertheless actuaries have a limited role with regards to defined contributions plans, since such plans by definition do not generate a pension obligation for companies. This role will be more financial and in relation with the asset and liability matching required along the retirement phase, as new plans will need to offer secured annuity payments to retirees. Prudential rules have still to be determined by the regulations for PERP and PERCO plans.

# Germany

## 8

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 8.1 Still the overwhelming majority of occupational pension plans in Germany are on a defined benefit basis, although there is a small and growing interest in the establishment of defined contribution arrangements. Those defined contribution plans that do already exist are either funded through Pensionskassen, direct insurance or re-insured support funds (a special kind of German pension fund). An increasing number of companies provide defined contribution book reserve plans (cash balance plans), although these are –at least from an international accounting point of view defined benefit arrangements with a minimum return and hence the final benefit is guaranteed by the employer. Since 2002 (caused by the amendment of the Occupational Pension Act in 2001) defined contribution plans with a minimum guarantee (Beitragszusage mit Mindestleistung) may be offered by Pensionskassen, the new pension funds (Pensionsfonds) and direct insurance. Under this type of pension plans the employer (by law) or the institution providing the plan (by agreement) have to guarantee the total amount of contributions to be available at least at retirement age.
- 8.2 Under salary sacrifice arrangements a portion of salary may be foregone by the employee in exchange for either a contribution to a direct insurance/Pensionskasse /Pensionsfonds or additional benefits promised under a book reserve or re-insured support fund arrangement. Since 2002 every employed person covered by social security has a legal entitlement to convert partially his/her salary up to an amount of 4 % of social security ceiling into a pension plan contribution. The employer has to provide an appropriate occupational benefit scheme for the salary sacrifice arrangement.

#### *Third Pillar*

- 8.3 Insurance contracts are used widely to provide for additional retirement income. In the overwhelming majority of cases a traditional with-profit endowment structure is used.
- 8.4 The possibility of establishing special investment saving funds for individuals became effective on 1 April 1998 in Germany; these funds are neither providing life pensions nor covering any biometrical risk, but they provide lump sum benefits which may be paid out over a fixed period of time (so-called AS-Fonds). As AS-Fonds may not offer any tax advantages they are not very popular. In addition life insurance companies as well as (investment) banks may offer approved saving funds which are paid out after retirement with variable payments until age 85 and annuities deferred to age 85. Contributions to those saving funds are supported by tax relieves and/or state allowances (as long as the annual contribution does not exceed 2 100 EUR), so-called Riester products.

### **Legal/tax framework**

- 8.5 Defined contribution arrangements funded through direct insurance, Pensionskassen, Pensionsfonds or re-insured support funds must comply with the Occupational Pension Act in Germany.
- 8.6 Contributions to direct insurance and Pensionskassen are tax-deductible for the employer but are regarded as taxable income for the employee. Contributions up to 1 752 EUR per annum are taxed at a special flat-rate rather than the marginal tax-rate. The flat-rate equals 20% plus Church taxes etc which in total usually amounts to 23%. Benefits are tax free if paid in lump sum form (subject to certain restrictions). Pension benefits are partially taxable. In addition employers' contributions to Pensionskassen and Pensionsfonds up to 4 % of social security contribution ceiling are tax free, but the benefits from these contributions are fully taxable.

- 8.7 Contributions to a re-insured support fund are tax-deductible for the employer and are not taxed as income for the employee. The benefits when payable are taxed as normal income. If the support fund is to maintain its tax-free status various conditions are put upon the payment of contributions and on the not very restrictive level of benefits.
- 8.8 Under 'defined contribution' book reserve arrangements, the company is allowed to accrue a tax-deductible provision in its balance sheet subject to a maximum calculated in accordance with the relevant tax code, paragraph 6a EStG. 40 % of the benefits, when payable, up to 3 072 EUR represent tax free, but fully taxable income for the employees as far as it exceeds these limits. This rule also applies to benefits paid from a re-insured support fund.

### **Product structures and providers**

#### *Defined contribution direct insurance arrangements*

- 8.9 Under a defined contribution direct insurance arrangement contributions are paid to an insurance contract held with an insurance company. The level of contribution is typically specified as a Euro amount although some arrangements are found whereby a percentage of salary is paid. It is common practice to limit the amount of the contribution to that which applies for flat-rate tax purposes, ie 1,752 EUR per annum. In the overwhelming majority of cases contributions are paid to a with-profit endowment contract paying lump sum or pension benefits. In such cases contributions are awarded a guaranteed rate of return (usually in the range of 3% to 4%, but 2,75% for policies starting later than 31.12.2003) but with the benefits payable on retirement or death being regularly increased due to profit-sharing on investment return and other experience earned over and above that guaranteed in the relatively conservative premium basis calculation. The guarantees are given by the insurance company rather than the employer and hence, although under most of these arrangements a benefit is defined for the employee in terms of a minimum retirement benefit and a minimum benefit on death, the underlying obligation of the employer is to pay a fixed level of contribution.

#### *Pensionskasse*

- 8.10 A Pensionskasse can be seen as a form of insurance company sponsored by a single employer or group of employers. Where a Pensionskasse is used to provide a defined contribution arrangement the structure is typically similar to that described above for direct insurance. Typically, contributions are defined either as a Euro amount or as a percentage of pay. Since 2002 a Pensionskasse may offer unit link pension products as long as it guarantees the total amount of contributions to be available at least at retirement age. Since 2002 more than 20 new Pensionskassen have been set up by life insurance companies in order to provide deferred annuity policies under more favourable tax conditions.

#### *Pensionsfonds*

- 8.11 A Pensionsfonds does not provide insurance products. Either the benefits are guaranteed or the future contributions are fixed, but not both elements at the same time. They do not allow access for individuals but only for employees of associated employers. Typically a Pensionsfonds runs defined contribution arrangements with a minimum guarantee. The product has to provide old-age benefits but it may also include disability and spouses'/orphans' benefits.

#### *Re-insured support funds*

- 8.12 Under a re-insured support fund contributions are paid by the employer to a support fund and then immediately paid on to and invested in a group insurance contract. The group insurance contract in this case will consist of a with-profit endowment or deferred annuity contract similar to that described above for direct insurance. Contributions are generally specified as a percentage of salary or as a Euro amount. The insurer under the with-profit contract will guarantee a minimum level of return but will usually enhance the benefits through profit-sharing. Unit-linked insurances can be used under certain conditions for re-insured support funds.

*Defined contribution book reserve schemes*

- 8.13 Under these type of arrangements each year a notional contribution is awarded to an employee's notional account held with the company or converted into pension benefit. This notional contribution may be defined as a Euro amount or as a fixed percentage of salary with differing rates applying above and below the social security ceiling. The notional account may then either be awarded an addition of interest each year which may be at a fixed rate or at a variable rate with a certain minimum applying. The employer will also specify the rate at which the accumulated employee notional fund is converted into pension benefit. In reality these arrangements are defined benefit arrangements since in order to obtain a deduction for the book reserve a benefit needs to be specified in advance.

# Greece

## 9

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 9.1 At present, pension plans are not as widespread in Greece as in many other European countries. However, pension plans are becoming more popular and the number of plans has increased over the last few years.
- 9.2 Following the growth of pension arrangements, defined contribution plans are also gaining in popularity and for some insurance company providers the proportion of defined contribution schemes is as high as 50 percent.
- 9.3 Plans typically define the contribution rate as a percentage of pay, with different rates often applying above and below the social security (IKA) ceiling.

#### **Legal/tax framework**

- 9.4 As yet, no major legal or regulatory controls are in place for defined contribution arrangements. This is partly because almost all of the existing plans are classified by the regulatory authorities as defined benefit deposit administration funds.
- 9.5 Investment decisions for defined contribution arrangements are usually arrived at jointly by the contract holder and the investment company. Their popularity is largely due to their transparency.
- 9.6 Employer contributions are tax-deductible subject to a limit of the lesser of 5% of pay or EUR 441 per person (1998). Employer contributions are not considered a benefit-in-kind for employees up to the limits described above.
- 9.7 Employee contributions to second pillar schemes and private life assurance plans are tax-deductible as follows. Contributions up to EUR 441 are tax-deductible in total. Contributions more than EUR 441 are tax-deductible at 40%, subject to a minimum of EUR 441 and a maximum of EUR 735. This maximum limit is expected to become EUR 1,000 as of 1 January 2003.
- 9.8 Pension benefits are taxed as income. Lump sum benefits from insured plans are tax free but subject to a stamp duty tax of 3.6%. This stamp duty tax is expected to be cancelled, as of 1 January 2003.

#### **Product structures and providers**

- 9.9 Defined contribution arrangements are typically funded through deposit administration insurance contracts.

#### **The role of the actuary**

- 9.10 There are no special provisions regarding the role of the actuary. Indeed, progress in occupational schemes and private pensions has been slow and painful. There are entrenched attitudes regarding state social security schemes and therefore considerable resistance to reform. As a result, legislators have been "dragging their feet".



# Ireland

## 10

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 10.1 The overwhelming majority of occupational pension plans in Ireland operate on a defined benefit basis although there is an increasing interest in the establishment of defined contribution arrangements particularly amongst new employers and American multinationals establishing in Ireland. The annual benefit survey undertaken by the Irish Association of Pension Funds indicated that only 7% of pension schemes were operated on a defined contribution basis in 1991 whilst by 1998 that percentage had increased to 16%. The 2002 survey showed that among companies with 50 or more employees, 13% offered defined contribution schemes only and a further 18% offered defined contribution and defined benefit schemes, or hybrid arrangements. Additional voluntary contributions by members of defined benefit schemes are, however, invariably managed on defined contribution lines.
- 10.2 Defined contribution schemes normally require a contribution from the member with the employer paying either a fixed contribution expressed as a percentage of pensionable salary or a tiered percentage contribution which increases with age. Concern has been expressed at the relatively low level of aggregate contribution being paid to new defined contributions schemes. It seems unlikely, in the absence of continuing exceptional investment returns, that the level of pensions delivered from the schemes at retirement will match those traditionally provided under defined benefit schemes.
- 10.3 The joint contributions to defined contributions schemes are directed to individual retirement accounts under the umbrella of a separate trust established by the employer. The individual retirement accounts are invested in unitised managed fund contracts offered by the insurance companies/investment managers or smoothed with profit contracts offered exclusively by the insurance companies.
- 10.4 The self-employed and employees in non-pensionable employment save for retirement through retirement annuity contracts. Retirement annuity contracts operate exclusively on defined contribution lines with the investment options similar to those available to occupational pension schemes.

#### *Third Pillar*

- 10.5 Life insurance contracts are used widely to top-up employee savings for retirement. Investment is invariably directed to a unitised managed fund type contract.

### **Legal/tax framework**

- 10.6 Defined contribution schemes established by employers are set up under trust and must be approved under the provisions of the Taxes Consolidation Act 1997. Contributions paid by both employees and employers to the schemes are treated as an expense for income tax purposes whilst no income/capital gains tax is levied on the accumulating retirement accounts. On retirement a proportion of the accumulated sum standing to the credit of the member can be taken by way of a tax free lump sum whilst the balance of the account proceeds must be converted into taxable pension by reference to annuity rates ruling at the date of retirement. The ultimate benefits payable cannot exceed those set down by the Revenue Commissioners. These benefit levels are identical to those that apply to defined benefit schemes.

- 10.7 Contributions to retirement annuity contracts by the self-employed/employees in non-pensionable employment also qualify in full for tax relief and the investment earnings accumulate within the individual accounts on a tax free basis. On retirement 25% of the accumulated assets can be taken in the form of tax free cash with the balance being applied to purchase taxed pension by reference to then current immediate annuity rates. Alternatively, the balance may be transferred (subject to certain criteria being met) to an Approved Retirement Fund from which capital and income may subsequently be drawn subject to deduction of income tax. The Revenue Authorities impose a limit on the percentage of annual remuneration which can be paid to a retirement annuity contract but there is no monitoring of the ultimate level of retirement benefits secured.

#### **Pensions (Amendment) Act 2002**

- 10.8 In 1998 the Pensions Board published its report in the National Pensions Policy Initiative (NPPI) - a comprehensive review of retirement provision in Ireland. The NPPI was prompted by the realisation that only about 50% of the employed/self-employed workforce was covered by second pillar pension schemes and that the existing structures were failing atypical workers e.g. part-time and job sharers. One of the main proposals to tackle this problem - the introduction of personal retirement savings accounts (PRSAs) is now being implemented by the Pensions (Amendment) Act 2002. PRSAs are expected to be on sale by early 2003.
- 10.9 The new product is intended to be attractive to a typical/mobile employees but would be available to employees generally and of most significance would be independent of their employment status. The PRSA could receive contributions both from the employee and his employers over time. The PRSA's would be operated on defined contribution lines and tax reliefs both on contributions paid and on investment income would be similar to those available under existing occupational pension schemes and retirement annuity contracts. Bearing in mind the mis-selling lessons of the UK the PRSA products offered by the insurance companies/investment managers would be required to meet prescribed criteria. In addition, the Act prevents a transfer from an occupational pension scheme to a PRSA where the member has had 15 or more years' service in the scheme.
- 10.10 The hope would be to increase second pillar pension coverage from the existing 50% up to approximately 70% of the working population over age 30 within a reasonable period of time. Quite clearly if the PRSA concept is successful a very much higher proportion of the workforce in Ireland will look to defined contribution type pension arrangements for retirement provision than has been the case in the past.

#### **Product structure and providers**

- 10.11 Covered in the above text.

# Italy

## 11

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 11.1 Traditionally the comprehensive nature of the social security system in Italy combined with the mandatory termination indemnity (TFR) meant that the scope for occupational pension arrangements was limited. Historically only a few companies set up pension arrangements for their employees and those pension funds that did exist were generally defined benefit in nature. The possibility for defined contribution arrangements will emerge in 1995-1998 following the pension law of April 1993 which was recently enacted. This is leading to the establishment of industry-wide schemes or regional schemes.

#### *Third Pillar*

- 11.2 Under the new pensions law it will be possible to have open pension funds which can be set up to allow employees not in a specific company or industry-wide scheme to participate in a third pillar pension arrangement on a defined contribution basis. It will be also possible to have a PIP (Individual Pension Plan) that is a particular insurance policy with social security purpose.

### **Legal/tax framework**

- 11.3 Taxation is designed according to a hybrid E(T)T system:
- contributions are exempted up to the lower of EUR 5,165 and 12% of personal income (in the case of employees, under the condition that a part of the severance pay (TFR) is paid into an occupational pension scheme);
  - investment returns (including accrued capital gains/losses) are taxed at 11% tax rate;
  - benefits are taxed net of the part already taxed as investment return:
    - lump sums are taxed at a favourable rate (provided they do not exceed 1/3 of total capital at retirement);
    - annuities are taxed as personal income.

### **Product structure and providers**

- 11.4 It is envisaged that the arrangements that will be established under the new law are likely to be on a regional or industry basis. Contributions are likely to be fixed as a percentage of an employee's income and will be invested in unit-linked/individual accounts. It is not anticipated that there will be any form of guaranteed return on the investment of the contributions. The main administrators of the arrangement are likely to be banks, insurance companies, SIM and SGR; these last two are particular society invest on securities markets (in most cases they are directly controlled by banks and insurance companies).

### **The role of the actuary**

- 11.5 At the moment, a Defined Contribution Pension Scheme is not required to have any actuarial valuation.

# Luxembourg

## 12

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 12.1 Although company sponsored arrangements are not widespread in Luxembourg, where they do exist they have traditionally been on a defined benefits basis through final salary plans. Defined contribution plans have been used to provide a top-up to the main benefits.
- 12.2 More and more companies operating defined benefit plans are changing to a defined contribution arrangement.

#### *Third Pillar*

- 12.3 The main vehicle for providing third pillar retirement savings is through privately held insured annuity contracts which are usually on a with-profit basis.

### **Legal/tax framework**

- 12.4 Defined contribution plans must comply with the legal tax framework. This requires them to be based on a pension promise in an employer/employee relationship.
- 12.5 Employer contributions to a defined contribution arrangement are tax-deductible on the basis that the requirements of the legal tax framework are met. Benefits can be payable as a lump sum or annuities. Employee contributions are fully tax-deductible up to a certain limit.

### **Product structure and providers**

- 12.6 Defined contribution plans are established with insurance companies or pension funds. The products used are with-profit deferred annuities with a guaranteed interest rate (of 2.5% actually), unit linked insurance products or pension funds. For both unit linked insurance products and pension funds, the supervisory authority requires of the employers to offer always the choice to invest contributions in a guaranteed deposit (minimum guaranteed interest rate of 0%) or an usual life insurance.

# Netherlands

## 13

### The role of defined contribution arrangements

#### *Second Pillar*

13.1 Although second pillar arrangements are in general very widespread in the Netherlands, either through company sponsored arrangements or industry-wide schemes, these have traditionally been overwhelmingly on a defined benefit basis through either final salary or career average plans. Defined contribution plans are however enjoying increasing popularity and are being used to:

- provide a top-up to the group plan benefits
- as a separate plan to finance early retirement benefits as a replacement for VUT schemes
- as a comprehensive main plan to replace an old defined benefit plan
- as the main plan for new companies or for new employees.

13.2 Some companies operating defined benefit plans are considering changing to a defined contribution arrangement.

#### *Third Pillar*

13.3 The main vehicle for providing third pillar retirement savings is through privately held insured contracts, either on unit-linked bases or on an annuity contract which are usually on a with-profit basis.

### **Legal/tax framework**

13.4 Defined contribution plans must comply with the Pension and Savings Fund Act. This requires them to be based on a pension promise in an employer/employee relationship and to be insured with an approved insurer or pension fund.

13.5 Employer contributions to a defined contribution arrangement are tax deductible on the basis that the requirements of the Pension and Savings Fund Act are met. Benefits must be payable in pension form. Employee contributions are fully tax deductible.

13.6 The contribution levels allowable under defined contribution schemes have to be approved by the tax authorities. This is to avoid excessive benefits being provided through defined contribution plans. The maximum allowable contributions are based on a target of 70% of final pay not being exceeded after a career of 40 years. The tax authorities have produced tables with maximum premiums; depend on age, pension age etc. The tax inspectors can allow higher premiums. The employer had to prove that.

## **Product type/structure**

- 13.7 Most defined contribution arrangements are currently invested through group pension insurance contracts. The contributions are usually specified as a percentage of salary with a salary offset to allow for the State benefits. Plans where a fixed contribution rate is applied to all employees are found as well as those where contribution rates vary with, for example, increasing age of the employee. The contributions are invested either in unit-linked arrangements with no investment guarantee or a traditional with-profit endowment/deferred annuity contract whereby the insurance company will guarantee a certain minimum return (usually 3%) with bonuses being awarded to reflect returns over and above the guaranteed amount, in the latter case there is usually no influence from the member on the investment policy.

### **The role of the actuary**

- 13.8 Except for a consulting role with regard to the plan design, the role of the actuary is negligible.

# Norway

## 14

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 14.1 Company sponsored pension arrangements are quite widespread in Norway, but traditionally they have been almost exclusively organised on a defined benefit basis, usually through final salary plans. This is primarily due to former tax legislations.
- 14.2 Effective from 2001 new legislation allow for defined contribution plans under the same tax regime as for defined benefit plans.
- 14.3 Although no special tax incentives exist the number of defined contribution arrangements for top management and pre-retirement are expected to increase.

#### *Third Pillar*

- 14.4 The main vehicle for providing individual retirement savings has traditionally been through privately held annuity contracts. Mutual fund savings arrangements and pension savings through banks have now been placed on the same footing as savings through life insurance with respect to tax treatment. At the same time life insurance companies are gradually introducing more flexible products. It is therefore expected that the market for individual retirement savings will gradually become more sophisticated.

### **Legal/tax framework**

- 14.5 Contributions to a defined contribution arrangement are tax-deductible within certain limits for the employer. The benefits will be fully taxed as they fall due. There will be no capital tax or tax on investment return during the saving period.

### **Product structure and providers**

- 14.6 The implementation of defined contribution and unit linked group occupational schemes will create a more dynamic pensions industry in Norway, with more providers (banks, asset managers and life insurance companies) authorised to offer pension schemes. Reasons for introducing defined contribution schemes are strong demands from employers and employees, as well as cross border competition. Aligning Norwegian legislation more closely to that in the European Economic Area is in itself an objective.
- 14.7 Employers want pension schemes with more flexibility. They require a higher degree of cost-control and more individualised schemes that allow the involvement of their employees. Simpler rules for accounting of pension costs will apply to DC schemes, which could contribute to making these schemes more attractive.

#### *Requirement regarding membership and retirement age*

- 14.8 In order to join the pension plan, an employee must work a minimum of 20 % of normal employment hours and be at age 20 at least. As with the state pension, the retirement age is 67 years.

### *Maximum contributions*

- 14.9 The law sets certain restrictions on the size of the company contributions. The company can contribute up to 5 % of income above 2G (2 times G, G = NOK 56.861 per 1.5.2003). In addition, the company can allocate extra contributions for employees with income between 6G and 12G. These limits are set because the Norwegian state pension decreases with increasing income. The breakpoint is at 6G, after which the state pension drops relatively steeply. (6G = NOK 341.166 and 12G = NOK 682.332, per 1.5.2003)
- 14.10 There will be no tax deduction for income over 12G. If the company chooses to pay extra contributions for income between 6G and 12G, the pension relative to income will be similar to a DB (Defined Benefit)-plan for all income levels up to 12G.
- 14.11 Extra contributions will be allowed for women, as they statistically live longer than men.

### *Investment choice*

- 14.12 The company can choose between DC schemes without investment choice and schemes that allow individual investment choice. If the company selects individual choice of investment, employees are given investment options.
- 14.13 In DC schemes without investment choice, the provider will decide how savings will be invested. A guaranteed yearly return will normally apply to such schemes.
- 14.14 In DC schemes with individual investment choices, each employee makes his investment choice. To start off the savings, the company invest the contribution the same way for all employees. Subsequently the employee can choose whether to continue investing in the same funds or to reallocate the portfolio. The employee receives the total return, positive or negative and takes the investment risk personally.
- 14.15 In plans with individual investment choices, the company decides to what extent their employees should have investment choices. We expect employers to offer both plans that will give a limited number of choices for the members, and plans where the employees allocate the savings freely.

### *Maturity*

- 14.16 The company can decide that on retirement, their employees must transfer the fund value to a life insurance company to buy a life annuity with a guaranteed level of return. The company can alternatively allow the employee to decide what type of annuity to buy.

### *Insurance cover*

- 14.17 In Norway, companies subscribe to insurance cover connected to pension saving. This can secure the financial situation of the surviving relatives if the employee should die. In addition the company can buy insurance cover which provides payments to a disabled employee who is unable to work.

### *Combined and parallel plans*

- 14.18 Parallel DC- and DB-plans (DB: Defined Benefit) have been permitted since 1.1.2001. Combined plans have recently been allowed. In parallel plans each employee chooses whether to be a member of the DB-plan or the DC-plan. When the plans are combined, all employees will be members of both plans.



## **The role of the actuary**

- 14.19 The actuary has the same role in DC-plans as for any other life product (including DB-plans). By law the appointed actuary should, among other things, be responsible for premiums and reserves.

# Portugal

## 15

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 15.1 Until recently supplementary pension plans were not widespread. Due to cutbacks in State benefits there has been an increasing interest in company sponsored pension arrangements. Some of these newer arrangements have been established on a defined contribution basis. Defined contribution plans are established either through direct insurance or through pension funds which are established on the basis of "open" pension funds (pooled pension funds) or "closed" pension funds (pension funds restricted to a single employer or employer group).
- 15.2 It is expected that as State benefits are cut back further there will be an increasing role for occupational pension arrangements and that a proportion of new arrangements will be implemented on a defined contribution basis.

#### *Third Pillar*

- 15.3 Employees typically use insurance arrangements to supplement their retirement income. Individual pension arrangements exist, referred to as PPRs.

### **Legal/tax framework**

- 15.4 Pension funds are regulated by the Insurance Supervisory Body, the ISP. The ISP impose restrictions on the investments held by pension funds and life companies. Employer contributions to pension funds and insurance contracts are tax deductible up to a maximum of 15% of payroll provided certain conditions are met, in particular that the benefits are paid as pensions not lump sums (up to 1/3 of the pension can be converted to a lump sum), there is no early retirement, the plan is extended to all employees on a non-discriminatory basis, and the retirement benefits are not vested.
- 15.5 The employer contributions to such plans are not considered as taxable income for the employees. If the plan offers vested benefits the employer contributions are considered a taxable benefit-in-kind in the hands of the employee and the employer can deduct contributions for corporate income tax purposes. Special arrangements apply to banking sector employees. If the plan provides vested benefits but complies with all the other conditions then the employee may deduct the employer contributions from their taxable income up to 15% of their annual gross pay. 25% of employee contributions to company sponsored arrangements are income tax deductible, with a limit of EUR 53,81 (2002) for a single employee.
- 15.6 25% of contributions towards individual pension plans (PPRs) are income tax deductible, with a limit of EUR 648,44 for a single employee.
- 15.7 Pensions from private pension plans, where the income from both the pension plan and the social security arrangement exceeds an income tax threshold (Pte 1,420,000), are fully taxable as personal income.

### **Product structure and providers**

- 15.8 Defined contribution arrangements are typically provided by insurance companies or pension funds.

# Spain

## 16

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 16.1 Until the early 1990's, most Spanish company sponsored pension arrangements were defined benefit arrangements. Sometimes these are funded through book reserves, but frequently they were unfunded and dealt with on a pay as you go basis.
- 16.2 The introduction of accounting legislation in 1990 requires the recognition of the cost of providing pension arrangements in a company's balance sheet. This caused many plans to be terminated or, more frequently, substituted by defined contribution plans.
- 16.3 Under the Law of Pension Plans and Pension Funds of 1987 (Law 8/87), a defined contribution pension plan is a pure savings arrangement under which the benefit cover arising from any event (death, disability and retirement) can only be the lump sum resulting from the accumulation of the contributions made and their yield (this lump sum can then be used to buy an annuity, usually from an insurance company). The Law establishes that in a defined contribution plan, during the period before benefit payment, no guarantee can be provided at all, not even a minimum interest guarantee. Under such plans all risks (mortality, disability, death and the financial-risk resulting from the volatility of the market) have to be taken by the participant, with no possibility of insuring them. Otherwise the scheme would be a defined benefit one.
- 16.4 However, if the plan corresponds to the second pillar (sponsored by the employer) then the defined contribution plan can be combined with some guaranteed coverages (the plan is then called "mixed plan"). Many of these second pillar plans guarantee a minimum coverage in case of death or disability of an active employee if the accumulated fund, at the moment of death or disability, has not yet reached that floor.
- 16.5 Decreases in the value of the assets of most of the funds backing this type of plans (in 1994 or last years) has created a great confusion among the participants, as they saw that at the end of the year their rights were lower than those at the beginning of the year plus the annual contribution. Since then many managers of such funds invest at a relatively short term in order to reduce volatility. This investment policy is negatively affecting the final results obtainable in many cases, especially for young participants.
- 16.6 Last year there was an increasing trend to invest in stocks reaching an average share about 15% - 30%, but this increasing trend has stopped with bad returns.

#### *Third Pillar*

- 16.7 Beyond the first two pillars, individuals may decide to save in order to improve their retirement income. One method of saving is through individual pension plans established under the Law 8/87. These plans are required to be of a "pure" defined contribution nature. Contributions have a maximum limit and are deducted from taxable income. Benefits when received will be treated as taxable income.

## Legal and tax framework

- 16.8 Defined contribution pension plans are regulated by the Law 8/87. There is a maximum annual contribution for the employer (in the case of second pillar), which in 2002 is EUR 8.000 for employees under 53 years old. For employees over 52 years old, this amount is increased by EUR 1250 for each year over 52, up to EUR 24.250 for 65 years old or over employees. Employees can contribute up to the same limits (as second pillar as third pillar).
- 16.9 The contributions paid to these plans are deducted from the taxable income and the benefits will be taxed when received as the rest of income, with a reduction of 40% in the case where the benefit is earned as a lump sum (and without reduction if it is an annuity).
- 16.10 Plans established under the Law 8/87 cannot be surrendered. The amount accumulated at any time can be transferred to another plan, but cash can only be received by the participant, or the beneficiary, when a contingency occurs (death, retirement or disability, recently extended to unemployment and dread diseases).
- 16.11 Alternatively insurance products and mutual funds do not attract any deduction in the taxable income from the amounts allocated to these products, but the benefits will be taxed only on amounts exceeding the contributions paid. These products offer early cash payout (through surrender in the case of insurance) when the participant requires it even if no contingency has occurred.

### Product structure and providers

- 16.12 Covered in the above text.

### The role of the actuary

- 16.13 A non-insured Defined Contribution Qualified Pension Plan is required to have an Actuarial and Financial review conducted at least once every three years to review some issues related to the Pension Scheme:
- a) Contributions have been calculated according to the rules of the Plan
  - b) Projection of the contributions and benefits until the next review
  - c) Assessment of the Plan Solvency (i.e. in case of paid benefits)
  - d) Assets of the Pension Scheme invested on short term are enough to pay projected future benefits until the next revision.

This review needs to be carried out by a qualified actuary but the law states that can be substituted by a report from the Manager of the Fund.

- 16.14 In addition actuaries to Defined Contribution Pension Schemes provide illustrations for scheme members of the member's projected benefits in some cases:
- a) When the plan rules establishes that contributions will stop when the projected benefits overpass a certain % of the final salary
  - b) When level of benefits should be compared to a prior transformed DB scheme.

# Sweden

## 17

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 17.1 Second pillar arrangements are very wide-spread in Sweden. Most individuals are a member of one of the two nationwide pension plans; the one for the blue-collar workers (Avtal pension SAF-LO) or the one for the white collar-workers (ITP). These pension schemes came into force following a collective agreement between the parties of the labour market. These two big pension plans (together with some other pension plans for specific professions) cover most people employed by private companies in Sweden.
- 17.2 A new Defined Contribution Agreement for the blue-collar workers (Avtals pension SAF-LO) pensions came into force 1996 with a four year transition period. The plan was changed from a Defined Benefit plan, though multi-employer out of the employer's perspective.
- 17.3 For the white-collar workers, the existing plan is mainly a defined benefit scheme, although one third of the premium goes to a defined contribution scheme. There have been discussions going on for several years for changing the existing plan. The employers organisation want a defined contribution plan, but the employees organisation would like to retain a modified version of the defined benefit plan.
- 17.4 White-collar employees earning more than 10 times the base amount (SEK 37,900 in 2002) may opt out of the Defined Benefit ITP-plan and take out pension insurance on a Defined Contribution basis.

#### *Third Pillar*

- 17.5 It is common in Sweden to have private savings in insurance companies, either a deferred annuity contract or a unit-linked contract. Other vehicles used for saving are bank accounts or unit trust funds.

### **Legal tax framework**

- 17.6 For occupational pensions, the premiums paid to an insurance company are normally tax-deductible. Generally, the employer is allowed to pay premiums up to 35 % of the salary to a pension arrangement, which can be either a Defined Benefit or a Defined Contribution plan. For early retirement arrangements, the tax-deductible premium may be higher.
- 17.7 Contributions are subject to a special social security tax (approximately 24%).
- 17.8 Swedish company sponsored pension arrangements do not require the employee to contribute. As a result, there are no special tax arrangements for employee contributions.
- 17.9 Premiums paid to privately held pension insurances are tax-deductible up to a limit of 0.5 Base Amounts plus 5% of income between 10 and 20 Base Amounts.
- 17.10 Benefits paid from occupational schemes represent taxable income.
- 17.11 Investment income on pension assets is taxed at 15 % based on a general investment income – rate set at the beginning of the year.

## **Product structure and providers**

- 17.12 Under the Defined Contribution arrangement established for blue-collar workers, contributions are made at the rate of 3.5 % of pensionable earnings. The contributions starts at the date of the employment, or at earliest at 21 years of age. Contributions are paid either to deferred annuity with-profit contracts in an insurance company or to unit-link contracts. Where a unit-linked fund is chosen, the employee is able to choose the type of fund the money is invested in. There are however no guarantees within the unit-linked business. For the deferred annuity with-profit contracts there is a guaranteed interest rate (approximately 3 %). Bonuses are normally paid to reflect excess investment returns.
- 17.13 The ITP over 10 Base Amount opt out arrangements are usually established using with-profit deferred annuity contracts or unit link contracts.

# Switzerland

## 18

### **The role of defined contribution arrangements**

#### *Second Pillar*

- 18.1 The provision of an occupational pension scheme has been mandatory in Switzerland since the enactment of the Federal Law on occupational old age, survivors and disability benefits in 1985 (referred to as the BVG).
- 18.2 The minimum pension to be provided is of a defined contribution nature and the BVG prescribes minimum employer and employee contributions. The employer must contribute at least 50% of the overall contribution. Each year the assets held in respect of the mandatory BVG minimum contributions must be increased with a minimum rate of 4%; as from 1.1.2003 the rate is reduced to 3.25%. The actual return will depend on the funds' rules and the investment returns may be smoothed from year to year.
- 18.3 The employer is free to choose either a defined contribution or a defined benefit plan for the BVG benefits. Traditionally most second pillar arrangements were defined benefit final salary plans, especially for larger employers. In most cases the employer will provide benefits that are better than the minimum BVG benefits.
- 18.4 Defined contribution plans are enjoying increasing popularity and are being used as either main benefit plans or to provide additional benefits for management.
- 18.5 Contribution rates are normally specified as a percentage of salary with both fixed and age related contribution rates found. Salary is usually capped and an offset is generally made to allow for state pension benefits. Benefits are taken in either pension or lump sum form.

#### *Third pillar*

- 18.6 Individuals who wish to make third pillar additional savings for retirement can use special blocked bank accounts or insured annuity policies. The BVG prescribes the conditions for these contracts and limits the allowable contributions.

### **Legal Tax Framework**

- 18.7 To fulfil its legal obligation the employer must either set up its own pension foundation or participate in a collective foundation. The latter are often established by insurance companies. In each case the entity must be separate from the employer.
- 18.8 The employer's contributions to defined contribution arrangements are tax-deductible if the pension scheme meets the requirements of the BVG. In addition, the contributions are not taxed as an employee benefit in kind. Employee contributions are also tax-deductible.
- 18.9 Benefits are taxable.

### **Product structure and providers**

- 18.10 Defined contribution plans for smaller employers are typically funded through traditional with-profit deferred annuity contracts with an interest rate guarantee of 4%. Larger plans are funded through self-administered pension funds. An employer specific foundation can hold investments directly or invest via insurance contracts.

# United Kingdom

## 19

### The role of defined contribution arrangements

#### *Second Pillar*

- 19.1 Although defined benefit plans still exist in the UK, defined contribution pension plans have become increasingly popular. The increase in legislation governing defined benefit plans, the increases in pension costs due to improved longevity, the falling expectation of future investment returns and the impact of the accounting standard FRS17 have all contributed to company concerns over defined benefit plans and the increased popularity of defined contribution plans. Where new arrangements are set up they are nearly always of a defined contribution nature. Many companies have now closed their defined benefit plans and are providing defined contribution plans for new employees to the company. Some companies have also ceased pension accrual in their defined benefit plans and are providing defined contribution plans for future service for both existing and new employees.
- 19.2 A recent NAPF survey, indicated that in 2002 approximately 32% of occupational schemes were of a defined contribution nature. This represents an increase from 15% in 1997. In addition 30% of defined benefit schemes were closed to new entrants.
- 19.3 The contribution rates payable under defined contribution arrangements are often graded according to the age of the employee. In the 2002 NAPF survey the average rate of company contribution to defined contribution plans was 6.05% with members contributing 4.70% on average. This compares with average company and member contribution rates of 12.86% and 4.75% respectively to defined benefit plans.
- 19.4 Contributions have therefore been paid to defined contribution plans at a lower level than that implied by traditional defined benefit arrangements. Whilst company sponsored defined contribution arrangements are commonly found there has been an increasing interest among smaller employers to establish a group personal pension arrangement. A group personal pension plan is in reality a collection of individual personal pension plans set up with a single provider (see below).

#### *Third Pillar*

- 19.5 Members of company sponsored arrangements can make additional voluntary contributions in conjunction with their normal company scheme under an additional voluntary contribution arrangement either through the company pension arrangement or separately. Usually these arrangements are of a defined contribution nature with contributions payable to a building society account or an insurance policy, on a unit-linked or endowment basis.
- 19.6 Individuals may establish personal pension arrangements on a defined contribution basis usually with an insurance company, fund manager or bank. Personal pension arrangements are popular with self-employed individuals and those individuals whose employers do not operate a company pension arrangement. Personal pension arrangements may be used to contract out of the second tier of the UK State benefit (S2P).
- 19.7 Companies who do not have an occupational pension plan or a personal pension arrangement that satisfy certain minimum criteria, are required to make available a stakeholder arrangement for their employees. The stakeholder facility is normally of a defined contribution nature and similar to a personal pension. Although companies are required to provide this facility they are not required to contribute towards it.



- 19.8 There are other vehicles for applying third pillar savings. One of the most attractive vehicles because of the various tax advantages is the ISA (Individual Savings Account).
- 19.9 Outside of this vehicle third pillar savings will typically be through life assurance policies, either on a unit-linked or with-profits basis, or through banks/building societies.

### **Legal Tax Framework**

- 19.10 Occupational pension schemes need to be approved by the Inland Revenue and set up under a trust in order to obtain tax relief. If approval is granted both the employer and employee can obtain some tax relief on contributions. Tax relief for employees is granted on contributions up to 15% of earnings subject to a maximum of £99,000 pa (2003/2004). The contributions paid by the employer are allowable against company corporation tax and are not taxed as a benefit-in-kind for employees.
- 19.11 Benefits payable from approved company defined contribution schemes are restricted by the same limits as defined benefit schemes. In particular there are limits on the maximum salary and the maximum service that can be used to determine benefits. Part of the pension at retirement can be commuted for a tax free cash lump sum.
- 19.12 Pension benefits from defined contribution arrangements are taxed as income when they are paid.
- 19.13 Contributions to personal pension arrangements are tax-deductible up to certain limits. The tax-deductible limit for contributions is 17.5% at age 35 or less rising to 40% at age 61 or more. These contribution rates are applied to earnings subject to the earnings cap of £99,000 pa (2003/2004). There is no limit on benefits from personal pension arrangements.

### **Product type structures**

- 19.14 There is no single typical structure for a defined contribution arrangement, although most plans tend to require employee contributions of between 3% and 6%. Employer's contributions may be flat rate or age related and higher employer contributions are often paid for more senior employees. An alternative arrangement is sometimes found where the employer will pay a multiple of the level of contributions paid by the employee. Typically employer contributions are in the range of 4% to 10% of earnings.
- 19.15 Contributions will be paid into a trust and will accumulate in line with the investment return achieved by the assets backing the fund. Prior to July 1997, the investment return added to the fund was free from tax. However, the July 1997 budget changed this so that schemes are no longer able to re-claim Advanced Corporation Tax paid on UK equity dividends.
- 19.16 Where insurance contracts are used as the investment vehicle the contracts may be on a with-profit, unitised with-profit or unit linked basis. The use of the latter two products is becoming increasingly dominant within insured types of arrangements.

### **The role of the actuary**

- 19.17 A non-insured Defined Contribution Pension Scheme is required to have an actuarial valuation conducted at least once every three years to ensure that the Pension Scheme satisfies two tests namely -
- a) the projected retirement benefits for each member is less than the maximum Inland Revenue approvable benefits for tax purposes and
  - b) the assets of the Pension Scheme are no greater than 105% of the liability for the past service benefits.

These tests, actuarial report and certificates need to be carried out by a qualified actuary.

- 19.18 In addition actuaries to Defined Contribution Pension Schemes provide illustrations for scheme members of the member's projected benefits. The Faculty and Institute of Actuaries has provided a recommended practice guidance note (GN34) which sets out the considerations an actuary needs to take account of when producing these illustrations.