

# Automatic Adjustment Mechanisms in the European pension systems

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- Traditional valorisation and indexation

Valorisation: inflating of year-by-year values of pension base calculation to the date of retirement

- DB: wages to career average calculation and
- DC: crediting interest on Pension Accounts

Indexation: regular – yearly – increase of pension benefits

- Sustainability factors of valorization and indexation

That is a factor multiplying the „normal” valorization and indexation measures

E.g. modified [„money weighted”] demographic ratio, measure of imbalance

Note: both examples are forward looking

- Adjustments used in the benefit formula – Typically linked to life expectancy

- Trigger mechanisms

Based on the result of actuarial valuation – That is about the „balance”

Or crossing a boundary in increase in life expectancy or GDP growth

Automatic or decision based

- Objectives – sustainability or adequacy
- Informal definition
  - Parametric changes
  - at points of intervention
  - according to predefined measures
  - unconditional/regular or
  - depending on predefined conditions and/or limits

## Automatic adjustment mechanisms

- are pre-determined measures ***[automatic]***
- applied on selected\* parameters of the system in conjunction with each other and successively in time in \*systemic approach and in relation with the objectives ***[systemic approach]***
- depending on the actual or projected status of the system, using its internal or external parameters as indicators ***[conditionality, triggering]***
- to change present and future pension values ***in relation with*** the status of the system, the indicators, or the objective criteria of sustainability and adequacy, intergenerational fairness. ***[subject to an explicit objective]***

# Automatic Adjustments and the EU – The Eurogroup Approach



Benchmarking of MSs' pension systems has been decided

- Performance indicators, including sustainability and adequacy indicators
  - Role of projected pension spending in Medium- and Long-term fiscal sustainability risks and Debt Sustainability Analysis (*DSA*)
  - Benefit ratio, relative poverty risk, replacement rates, coverage ratio
- Policy indicators
  - [Retirement age and Duration of active and retired periods policies]
  - [Pensionable earnings reference periods defining pension benefits]
  - Valorisation and indexation rules
  - Automatic adjustment mechanisms in narrow sense:
    - Retirement age link to life expectancy
    - Pension benefit link to life expectancy
    - Automatic balancing mechanism

# Automatic Adjustments and the EU – AAMs in the Reports

- Objectives: primarily sustainability
- Reforms are analysed in the Pension Adequacy Report
  - Lower pensions in 2056 because life expectancy is increasing faster than effective exit age
- AAM reforms according to point of intervention
  - Contributions: not a new reform, but major increase in Germany because of the sustainability factor
  - Linking retirement age to life expectancy increase: in several MSs
    - See also: the specific sensitivity test in Ageing Report: The policy scenario: Linking retirement age to change in LE
  - Valorisation and Indexation: AAM by definition – still changed frequently
  - Stabilizers: Estonia
  - Benefit formula reforms
    - Belgium: point system from 2030 and
    - Finland: cutting back the life expectancy factor from 2027

- The sustainability approach prevails in the Reports
- Indeed, the most effective use of AAM is linking retirement age to the change in life expectancy
- The valorisation-indexation measure is not regarded as AAM
- Stabiliser factors based on demographic projections
- Triggers based on regular actuarial balance projections has not been introduced recently
- In all, the use shows ad-hoc and not systemic (harmonised and consistent) approach