



ESPN – Flash report

2015/10

**Reform of the occupational pension system in
2015: safeguarding financial stability to avoid
pension system crisis**

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Theme	<i>Pensions</i>
Title:	Reform of the occupational pension system in 2015: safeguarding financial stability to avoid pension system crisis
Category:	<i>Reform proposals underway – ongoing policy debate</i>
Abstract:	<p>Liechtenstein's pension funds are facing fundamental challenges related to the ageing of the population and the low interest level on the capital market.</p> <p>In order to cope with these challenges and to improve sustainability, reforms are envisaged which should be effective as from 2016. The reform package consists of an increase of the contributions, a reduction of the affiliation threshold, an earlier beginning of the insurance contribution and an upward adjustment of the pensionable age.</p>
Description:	<p>The law on the occupational pension system with its mandatory contributions was introduced in 1989. At the end of 2013, 24 pension schemes existed in Liechtenstein and were under the supervision of the Financial Market Authority (<i>Finanzmarktaufsicht</i>).</p> <p>Company pension funds are the basis for the occupational benefit plan, which is the second pillar of the Liechtenstein pension system. Ideally, the pay-outs of the state pension fund combined with the occupational pension fund should correspond to 60% of the last salary of the contributor before retiring. The benefits from an occupational benefit plan can therefore be seen as additional allowances above the defined minimum income in Liechtenstein.</p> <p>The contribution system of the occupational pension structure is not based on a redistribution from workers to pensioners. Instead, each worker pays contributions towards his/her personal pension fund. In view of the demographic developments, if the present system remains unchanged then either benefits will become inadequate and old-age poverty will increase (because of the life time coefficient eating up the pension amount), or the system will become unsustainable (as the required capital return on market investments cannot be</p>

	<p>reached anymore to fulfil the pension payments based on the accrual rate calculation). To avoid this, the reform of the state pension fund system needs to be complemented with a reform of the occupational pension system.</p> <p>Options currently discussed by the government include:</p> <ul style="list-style-type: none"> • keeping the basic structure of the occupational pension system and avoid over-regulation to leave entrepreneurial flexibility to players in the occupational pension system; • increasing the earliest retirement age to 65; • linking more closely life expectancy and life time coefficient when calculating the pension conversion rate, which will lead to a more defined-contribution funded scheme and an increasing contribution system; • defining an earlier start of the insurance contribution; • restructuring the technical interest rate for the pension assets (no implied interest guarantee). The technical interest rate is used by the insurer in the evaluation for present values, prices and premiums.¹ <p>In 2014, the neighbouring Swiss Government declared the need to revise the Occupational Pensions Act as part of the structural reform of the Swiss Federal Law on Occupational Old Age, Survivors' and Invalidity Provision. Due to the agreement concluded between the Swiss Federal Council and the Government of Liechtenstein on performance of the responsibilities of the Liechtenstein guarantee fund, Liechtenstein is directly affected by the upcoming changes in the Swiss legislation. As a result, Liechtenstein's decision makers feel compelled to ensure equivalence of the legal framework governing occupational pensions and the supervision thereof.</p>
<p>Outlook & Commentary:</p>	<p>Based on the legal discussion and experts options, the above described measures are expected to lead basically to the following results²:</p> <ul style="list-style-type: none"> • one-step reduction of the coverage of the occupational pension; • lower interest rates (technical interest rate); • lower pension conversion rate (based on the life time coefficient);

¹The higher the technical interest rate, the lower the policy reserve, which is why regulators set an upper bound for the technical interest rate, called the 'maximum technical interest rate'. Regulation of the maximum technical interest rate is also relevant in that this rate is often related to minimum interest rate guarantees offered to customers. (Source: Working paper "Maximum technical interest rates in Life Insurance", M. Eling, S. Holder, 10.2012).

²No impact assessment has been scheduled by the government so far.

	<ul style="list-style-type: none"> • higher contribution payments by current policyholders; • earlier contribution payments for future policyholders; • a clear defined-contribution funded scheme. <p>Various associations and political parties strongly rejected some of the suggested measurements. Especially the idea of increasing the earliest retirement age and defining an earlier start of the insurance contribution does not find support. Opponents of the government proposal point out social adequacy concerns, e. g. increasing the retirement age will result in falling replacement rates and lower financial income of the elder ones.</p> <p>Overall, collective foundations of occupational pension companies will find themselves in a much more intensive market competition, which is expected to have a positive effect on the internal cost structure of occupational pension companies.</p> <p>The Government timetable focuses on an occupational reform which converges with the adaptation of the state pension funds system before the end of 2015. The objective is to put the necessary legislation into effect by the beginning of 2016.</p>
<p>Further reading:</p>	<p>Statement of the Deputy Head of Government as of 3. September 2014: http://www.gmg.biz/pdf.aspx?xsl=http://www.landtag.li/config/anfrage2pdf.xslt&xml=http://www.landtag.li/files/temp/kleineanfrage_77916.xml</p> <p>2014 analyses of the supervision institution of occupational pension companies in Liechtenstein, the Financial Market Authority: http://www.fma-li.li/fileadmin/user_upload/06_FMA/06_Publikationen/06_Veranstaltungen_und_Referate/FMA_betriebliche-Personalvorsorge.pdf</p> <p>Presentation at the conference of delegates of the Liechtensteinische Landesbank (LLB) occupational pension fund in 06/2013: https://www.google.li/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=15&ved=OCDQOFjAEOAo&url=https%3A%2F%2Fwww.vorsorgestiftung.li%2Fsitecore%2Fshell%2F~%2Fmedia%2FVorsorgestiftung%2Fpdf%2FVortragDrPluess-DV2013.pdf&ei=8T_kVOCWEYG7OOfmgfAC&usq=AFQjCNExwna_pPMb09ncLooCjBFULOZe64A</p>
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