Supplementary pensions: legal framework & requirements

Habiba Tassa
Senior Consultant, PhD, ADDACTIS® BeLux
habiba.tassa@addactis.com

addactis
Actuarial & Software Solutions

Contents

Since 2003, the supplementary or extra-legal pension has become a major topic in the context of the social consultation. This is a benefit which the employer may grant, but he is under no obligation to do so. In addition to it's extra-legal character, the supplementary pension is subject to several social regulations so as to protect employees' rights.

The Belgian Supplementary Pensions Act « LPC/WAP» entered into force as of 28 April 2003 and amended as of 3 January 2016 and has pursued the following objectives:

01 Ensuring adequate and sufficient pensions

02 Capitalization mechanism

04 Making Supplementary pensions safer

ENSURING ADEQUATE & SUFFICIENT PENSIONS

This objective is defined as a guarantee that supplementary pensions can reasonably allow affiliates to achieve a good standard of living since the state pension constitutes a «serious decline» in terms of a retiree's income in comparison with the last salary of the affiliate.

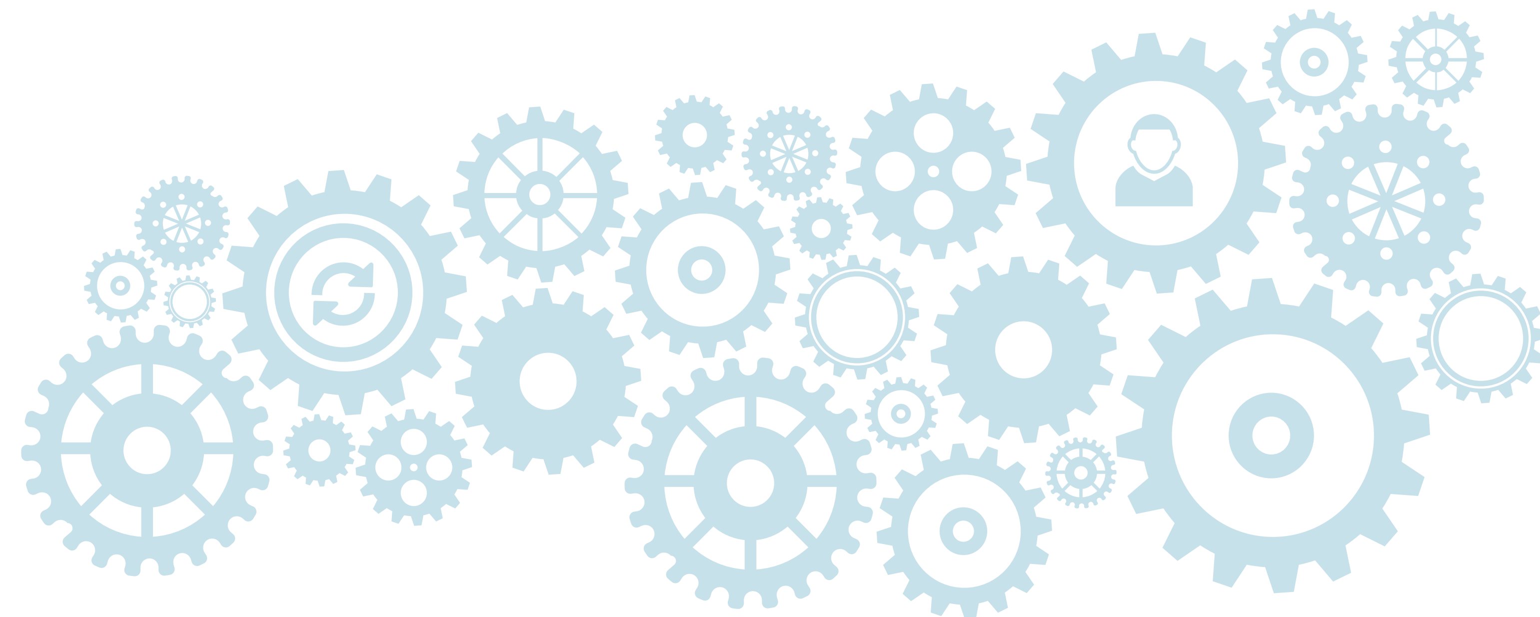
© 2018 addactis® – All rights reserved; any reproduction without written permission from addactis® is prohibited.

CAPITALIZATION MECHANISM

This objective is characterized by a requirement to use a funding technique. Accordingly, pensions are generated by the savings accumulated by the affiliates contributions. Indeed, the statutory pension system in Belgium is based on a DB pay-as-you-go system whereby pensions are paid by the current workers to the previous generation. PAYG system is sensitive to the ratio of primary old-age pensioners to contributors[1].

This creates a funding concern to statutory pensions in the current context, as the number of pensioners in Europe rises, and the relative number of working-age people declines.

A further aspect of the capitalization technique which makes it a safer system in comparison with the PAYS system, is that in a PAYG system, there is no protection in place for pensions when the employer goes bankrupt (or in the event of employer insolvency). Particularly since the employer makes long term commitments to its employees. A young worker aged 25 can stay in this fund for 40 years! There is, therefore, no guarantee that the employees' company will not disappear before such horizons. This risk is prevented by the capitalization mechanism since in the case of stopping system, provisions would be already constituted and the benefits of the affiliates would be saved.
On the other hand, these provisions are subject to a variety of measures for making them safer. Which meets a twofold requirement: Outsourcing of pensions and Solvency of pension plans.



[1]This ratio exceeds by far the dependency ratio derived from the population over the age of 65, divided by that aged 15-65, due to the large number of individuals that retire early.

© 2018 addactis® – All rights reserved; any reproduction without written permission from addactis® is prohibited.

3 MAKING SUPPLEMENTARY PENSIONS SAFER

By this obligation, the legislator seeks to protect affiliates against fluctuations on financial markets. Indeed, in a DB plan, this risk is supported by the pension plan sponsor where the benefits have been defined. They are generally related to the salaries and the years of service of the affiliate. However, in a DC plan, before the LPC/WAP act, financial risks (market and interest rate risks) were supported by the affiliates (the employees) as the return on their contributions was depending on the investment return.
In order to deal with this, the LPC/WAP act has established a minimum guaranteed return on the pension contributions (employee and employer contributions)[2]. The legislator also requires to ensure the safety of employees pensions: Outsourcing of pensions and solvency of pension plans.

1- Outstanding of pensions: obligation on companies to outsource their pension liabilities

Under the Act of 28 April 2003, control of a supplementary pension scheme must be managed by a separate pension institute that pays benefits to the affiliates at the time of retirement.
Pension benefits are separated from the capital of the employer by taking out group insurance (insurance undertaking) or by creating a separate legal person (pension fund). This rule aims to protect the affiliate's rights in case of insolvency of the employer.
Practically, in the case of group insurance, if the employer will be insolvent, the policy will continue to be managed by the insurance undertaking and reserves will be transferred to individual policies. In the case of a pension fund, if reserves will not be transferred to another pension institution, they will be transferred to individual accounts.

2- Solvency of pension plans

In Europe, pension institutions (group insurance and pension funds) are subject to successive directives in terms of Prudential Supervision. Group insurances are subject to Solvency II Directive, while pension funds are subject to the IORP directive. The specific aim of these measures is to reflect the risks that companies face. Pension plans have to improve a good equilibrium between the safety of their liabilities and the performance of their investments. To reduce the risk that a pension plan would be unable to meet liabilities, a minimum capital is required.
All Insurance undertakings play on the same financial international market, but it is worth noting that pension liabilities cannot be processed in a similar way as insurances with short-term guarantees. In this regard, the recent discussions about long term guarantees for life insurance in the context of the Solvency 2 project have illustrated this point. Accordingly, EIOPA launched the long-term guarantee assessment (LTGA) that aims to apply various measures regarding long-term guarantees. But, LTGA focused only on the evaluation of the adapted relevant risk-free interest rate term structure, extrapolation, matching adjustment and transitional measures.
However, the time horizon of the liabilities for long-term products as pension commitments was not taken into account in terms of the solvency strictly speaking. In particular, as a risk measure, the value-at-risk on a one-year horizon is still used.
The way to integrate the time horizon in the solvency process of pension plans is an important factor. But to date, the European directives have not provided risk measure tools adapted to the nature of pension products and the impact of the time horizon of the liabilities needs clearly to be taken into account in the future assessment measures for pension commitments.

[2] On 28 April 2003, the annual rate was set at 3.25% for employer contributions and 3.75% employees contributions. From the amendement of 1 January 2016, the guaranteed minimum return will be variable. The minimum return will be determined at 65% of the average return on 10-year linear bonds (OLOs) evaluated over the course of 24 months.

© 2018 addactis® – All rights reserved; any reproduction without written permission from addactis® is prohibited.

GET IN TOUCH WITH

addactis
Actuarial & Software Solutions

contact@addactis.com
www.addactis.com

There is always an addactis® expert close to you! Closer to your needs, with a fine understanding of your market and requirements.

We are YOUR ALTERNATIVE!