COUNTRY SPOTLIGHT GERMANY

Built for another era

Recent pension reforms in Germany sought to reduce the pressure on the first-pillar system while encouraging growth in the second- and third-pillar schemes. How successful have they been?

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The German pensions landscape is a fraught one. The country faces an ageing demographic, an over-reliance on first-pillar pensions, and a now years-long economic slowdown.

As Allianz research recently wrote: "Germany's ageing population continues to put pressure on its social security system, with non-wage labour costs rising significantly. Since Q1 2021, total labour costs have risen by 20 per cent, with non-wage labour costs up by a third, outpacing wage growth.

"With nearly five million people expected to retire by 2029, further increases are likely. Despite this, the coalition plans to maintain the current pension level of 48 per cent until 2031, with a reassessment in 2029, and to continue to allow full retirement after 45 years of contributions."

A compounding factor in this crisis, according to LBBW, is that Germany's shortage of skilled workers is slowing economic growth, eroding the base of social contribution payments.

Now, years into this decline and sleepwalking into oblivion, the current administration has brought into force the Company Pension Strengthening Act II (Zweites Betriebsrentenstärkungsgesetz, or BRSG II), which remains the biggest move – amongst others – in recent months to try and shift the landscape.

The legislation exists largely to increase the attractiveness of company pension schemes for consumers, reducing the pressure on the state's first-pillar system.

"I WOULD FOCUS ON MAKING THE FIRST PILLAR MORE SUSTAINABLE: NO NEW BENEFITS OR PROMISES"

But any success in this area, if it happens at all, will be incremental. In September, financial services giant PwC wrote of BRSG II that there were "no significant changes" with "the big breakthrough for company pension schemes… unlikely to happen".

While other reforms have been passed, they are largely seen to be tinkering around the edges of the system. The state has introduced the Aktivrente (the active pension), which means that retirees can earn up to €2,000 a month without paying tax – although this is limited to who can apply for it and excludes the self-employed.

It has also brought in a plan to give €10 a month to schoolchildren between the ages of six and 18 that goes into a retirement account. And from January 2027, the Mutterrente (mothers' pension) will be expanded, seeking to give equal recognition to the childcare contributions of parents during the first three years of each child's life. That final reform is slated to add €5 billion each year to the deficit.

The future is not yet here. In December, Merz said that the government was launching a Pensions Commission to build on the forms of BRSG II.

The Impacts of the reforms

WTW Germany head of retirement, Hanne Borst, weighs up the positive and negatives of BRSG II.

"On the positive side," says Borst, "access for low income employees is expected to improve, supported by higher subsidy limits and dynamic income thresholds under §100 EStG (Section 100 of the German Income Tax Act).

The social partner model would also gain greater flexibility and broader applicability, as the relaxation of the 'tariff applicability' requirement enables its use across entire union sectors. Employers may benefit from a reduced administrative burden, particularly through higher thresholds for settling small entitlements, which have historically required disproportionate effort."

She adds: "In addition, the modernisation of key pension vehicles – most notably Pensionskassen and Pensionsfonds – would allow for more contemporary investment and governance structures."

Deutsches Aktieninstitut (DAI), Dr Norbert Kuhn, says that the idea to introduce a pure-DC model is a "good step" but cautions that it will be a hard thing to get by Germany's trade unions, which remain strong and influential.

He says: "The attempt to introduce a pure-DC model, which is common internationally, is a good step. Firstly, it provides more leeway for investing in shares. And if it is set up well, SMEs should find it easier to provide occupational pensions. The problem is that it depends on the unions and employer associations agreeing."

He adds: "The unions are quite sceptical when it comes to these models."

There are limitations and drawbacks to the BRSG II. Borst says that there is unlikely to be a significant increase in overall coverage because the measures do not go far enough to drive a structural expansion of occupational pensions, especially within SMEs and among non-unionised workforces.

She adds: "The reform also misses an opportunity to address guarantee levels, which continue to restrict return potential in traditional models outside the social partner framework. Finally, the absence of a coherent long-term strategy persists, as BRSG II does not align private and occupational pension reforms into a unified and forward looking retirement policy."

The general impression of BRSG II from experts is that while the legislation does take steps in the direction of a strengthened DC scheme landscape, it is not the massive, thorough reform that many have been looking and campaigning for. This ship, it seems, is a hard one to turn quickly.

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This viewpoint has been reflected in the wider community. An overwhelming proportion – 98 per cent – of respondents to a live poll last year said that they did not think BRSG II would meaningfully strengthen workplace pensions.

A fragmented approach by the German government has also drawn criticism, with a common complaint being that there is no overarching strategy towards pension reform across all three pillars.

In November, Borst told *European Pensions*: "[*BRSG II*] ultimately falls short of addressing the structural issues that continue to limit the system's scalability and attractiveness. Overall, BRSG II is a constructive step, but not the breakthrough many stakeholders had hoped for."

Scepticism is elsewhere. The German Council of Economic Expert council member, Martin Werding, intimates that it was hard for governments to enact meaningful reform since their horizons were only set for five years or so until their next election.

He says: "It's a strong requirement for politicians to look ahead 10 or 15 years, not just to the next election. We had reforms here in Germany for the pension system in the late 1980s and then again in the early 2000s.

"At those times, the government cared about what would happen over the two decades, so they did meaningful things that people did not like such as increasing the pensions age and bringing in a mechanism for bringing down the pension level as the population aged. This has now been stopped until 2031, but is fundamentally at odds with an underfunded pension scheme."

The future of the German pension system

While Merz has announced a commission to look at future reforms, Borst says that she hoped for an "integrated framework" across all three pillars.

"Instead of reinforcing one another," she says, "elements of the second and third pillars risk cannibalising each other, which ultimately prevents the creation of additional retirement income. What is missing is a coherent, overarching strategy that defines the role each pillar should play in a future proof system."

Other priorities, says Borst, should be a genuine opt-out framework that is broad and legally supported, along with a reassessment of guaranteed requirements and a stronger focus on the decumulation phase.

She adds: "Germany would benefit from a transparent definition of an overall adequacy target for old age income, combined with coordinated designs for the second and third pillars that complement rather than compete with each other.

"Current inconsistencies undermine this goal. For example, the government proposes removing guarantees in the third pillar while maintaining strict guarantee requirements in the second pillar outside the social partner model. This creates asymmetries that are difficult to justify and even harder for savers to understand."

But IFO Dresden director, Prof. Dr. Marcel Thum, says that a "coherent strategy" risks making things complex and taking more time to implement.

He adds: "I would focus on making the first pillar more sustainable: No new benefits or promises; let the automatic stabilisers work, maybe with some more focus on the demographic effects; automatically increase the legal retirement age with life expectancy; eliminate the early retirement for the long-term insured; [*and*] adjust pensions with inflation rather than wages."

That is a lot of work. The question is how we get from here to there.