RISING LONGEVITY

How to solve a problem like longevity

Jack Gray investigates how pension systems across Europe are attempting to solve issues with ageing populations and what new trends are emerging

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Last year was a challenging and shocking experience for people around the world as the Covid-19 pandemic swept across the globe. The tragedy of widespread loss of life affected all areas of society, including the pensions sector. Following years of increasing life expectancy across Europe, the only three countries that saw a rise in 2020 were Denmark, Finland and Norway.

Although the pandemic is not over, vaccines and a greater understanding of the virus have led to many believing that last year was a statistical anomaly and life expectancy will continue to increase from this year. "Due to the coronavirus pandemic, mortality in 2020 was higher than expected," explains a Federation of Dutch Pension Funds spokesperson. "The pandemic is not expected to adversely affect the upward trend in life expectancy."

This brings the issue of longevity back into the limelight, with governments and pension organisations across Europe looking for solutions to an ageing population and analysing emerging trends.

Variable concerns

Looking at European Union (EU) member states together gives an idea of the challenges countries are facing. Between 2019 and 2070, the life expectancy at birth is expected to grow by 7.4 years for men and by 6.1 years for women, the working-age population will decrease by 8 percentage points as a percentage of the total population, and the EU's old-age dependency ratio is projected to rise from 35.3 per cent to 58.9 per cent.

"These alarming figures urge governments to assess the adequacy and sustainability of the pension system and to place pensions at the heart of social and economic policies at all levels," says PensionsEurope senior policy adviser, Simone Miotto. "In certain countries, governments should be very concerned about the impact of the demographic challenge on their pension systems and act promptly to ensure good pensions to all."

The scale of the issue varies from country to country, with Insurance and Pension Denmark senior consultant, pension and welfare, Lotte Katrine Ravn, noting, "as in most European countries", there are concerns regarding the increasing life expectancy of the population in Denmark.

"This increase, coupled with the extreme low-interest environment, has put increased pressure on long-term life insurance products," adds ATP head of pensions, Liselotte Milting.

However, this is not the case for all nations, with Tela manager, public advocacy, Janne Pelkonen, stating that there is "not much concern anymore" in Finland due to reforms in 2005 and 2017.

Solutions and strategies

"We now have two automatic stabilisers integrated in the statutory pension system in Finland," explains Pelkonen. "The life expectancy co-efficient was introduced in 2005 and implemented in 2010, and means that everyone born after 1947 has their pension levels adapted to their rising life expectancy.

"In 2017 we linked our retirement age to life expectancy. This also has a long implementation period and, starting from 2030, the lowest boundary of retirement age is going to be linked to life expectancy."

Indexation of life expectancy and retirement age is a common solution to the problem and is also used in the Netherlands and Denmark, among others. It aims to address affordability and labour issues by ensuring that there are enough people working to support those in retirement.

Ravn notes that the indexation in Denmark, introduced 15 years ago, has proven "very successful" and has had a "massive impact on the actual retirement age and thereby the long-term public economy".

"It was clear in the early 2000s that the Norwegian pension system was not sustainable," says KLP head of analysis, Lisa Marie Dickson. "Life expectancy was increasing, and birthrates were declining.

"Since 2011 a pension reform has been gradually implemented. Its key goal is to meet the challenges the demographic development represents to the financial sustainability of the pension system and to encourage people to postpone retirement and work longer.

"The actuarial life expectancy adjustment of pensions and new rules for pension indexation ensures sustainability, flexible retirement encourages people to retire later and thereby contribute to the workforce longer."

Flexible retirement can allow those who want to continue working, or to have more money in retirement, to do so, but it can also put risk on the shoulders of members. Dickson explains that if the member withdraws their pension too early and lives longer than expected, they will not have maximised their pension. However, if they wait too long they might die before they have profited on the higher annual payments that come with a late withdrawal.

Changes have also been taking place at a company level, Milting notes, with many pension firms in Denmark redesigning products to only provide guaranteed mortality in retirement, for example annuity pricing based on prevailing mortality at the point of retirement, aiming to limit longevity risk for younger pensioners.

"The solutions and strategies adopted have been very different," summarises Miotto. "They range from structural pension reforms, such as the one ongoing in the Netherlands that is transforming the occupational pension schemes from DB to DC with solidarity elements, to more spotted technical changes to the current existing structures."

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However, Miotto warns that the solutions and strategies adopted by national governments are not always long term, consistent or timely, as pension reforms are a very delicate issue from a societal, political, and budgetary perspective.

Emerging trends

Governments, associations and pension companies continue to try and stay one step ahead of demographic changes that shape pension policy. As the situation evolves, longevity trends that need to be addressed are emerging.

One key example is the polarisation of life expectancy between socio-economic groups. This brings questions of fairness, as if one group has a notably lower life expectancy than the other it may be unfair to have a one-size-fits-all retirement age.

"Even in Finland where we like to think of ourselves as a Northern European welfare state, there is polarisation of life expectancy between different socio-economic groups," states Pelkonen. "Those with lower education levels or work status have seen at best rather modest increases in their life expectancies. I think this is probably the case in most European countries."

Ravn notes that, in Denmark, parties in parliament are beginning to think that an official pension age of 72 by 2050 is presenting a "downside" for some employment groups, such as blue-collar workers.

"A newly established pension commission has been given the task to investigate a shift in the timeline of a life expectancy indexation and ways to simplify the pension system in general," she adds.

Meanwhile, in Norway, Dickson explains that people having to work longer is "putting increased focus on private savings in tier three".

Changes to working patterns and labour markets are also pushing pension reforms, as Miotto explains: "All forms of employment other than full time have considerably increased over the past few decades and their use has become more widespread across economic sectors and occupations. Still today, these workers are not always adequately covered by their pension system. Pension systems will need to be modernised to reflect the continuous changes in the labour markets to maintain and/or improve their income maintenance capacity and inclusiveness." ■