
Stabilising the German pension system – recommendations for the state, occupational and private pension pillars

February 2025

The challenge of stabilising the pension system

Summary of recommendations

- Strengthen the state pension by investing to generate long-term returns (for example, through the Generationenkapital fund)
- Consult on introducing auto enrolment schemes at national level and contribute to the assessment of products at European level
- Reform the private pension system to provide citizens with attractive products (for example, the proposed Altersvorsorgedepot)

This note is organised as follows:

- Context
- Pension systems and international comparison
- What are the options for Germany?
- Recommendations for the next parliament

Context

An aging population is placing a strain on Germany's statutory pay-as-you-go pension system. The contributions paid by workers are not sufficient to pay the pensions, and the government has to finance the deficit every year – in 2023 the deficit was around €100 billion – a gap that has to be bridged by the federal budget.

State pensions in Germany constitute more than three quarters (76%) of the income of pensioners, and occupational pensions constitute only 8%.

Nearly 60% of household financial assets in Germany are in deposits or life insurance – the share of typical capital market instruments (bonds, pension funds, investment funds or equities) is significantly lower than in other markets.

Existing private pension products have not delivered attractive returns for citizens.

There are signs that the population is becoming aware of the problem with the pension system and is beginning to invest more in the capital markets, particularly in the younger generations.

Experience from other countries points to some solutions which can also be effective in Germany.

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Pension systems and international comparisons

Pension systems typically have three pillars.

- First pillar – state pension
- Second pillar – occupational pension
- Third pillar – private pensions

Different countries have tried different approaches to securing their pension systems.

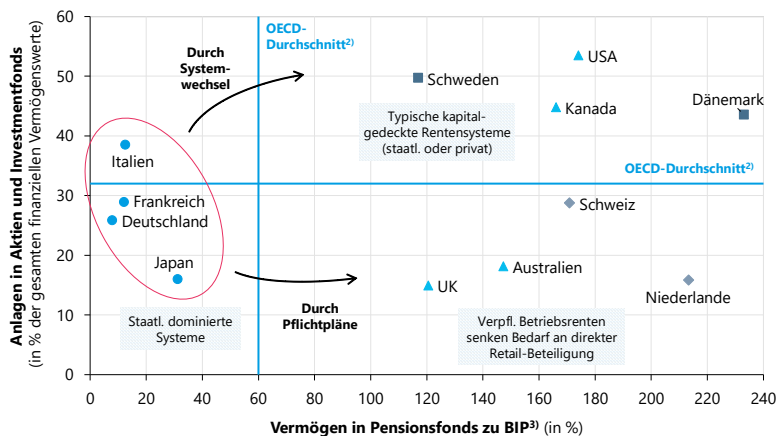
Several studies have been conducted, including AFME's study with zeb Consulting¹ and a study by the Deutsches Aktieninstitut²

Overview of studies

The zeb study shows how Germany's state pension system stands relative to other countries (see graph below).

Verhalten folgt Struktur: Staatl. dominierte Systeme gehen mit geringerer privater Kapitalmarktbeteiligung einher – kapitalgedeckte Systeme erhöhen indirekte Anteile

Korrelation zwischen Pensionsfonds und privater Beteiligung an Kapitalmärkten¹⁾



1) Aufgrund der Komplexität der internationalen Rentensysteme kann die vorliegende Analyse nicht alle Aspekte vollständig im Detail berücksichtigen; sie bietet jedoch eine valide Grundlage für die Diskussion über die Erhöhung der privaten Kapitalmarktbeteiligung durch mögliche Veränderungen im Rentensystem; 2) Ungewichteter Durchschnitt der OECD-Länder; 3) Pensionspläne inkl. kapitalgedeckter und privater Pensionspläne; Pensionsansprüche sind nur dann enthalten, wenn sie sich auf (kapitalgedeckte) beschäftigungsbezogene Systeme beziehen, was die länderübergreifende Vergleichbarkeit beeinträchtigen kann; Quelle: Mercer (2022), OECD (2023a, 2023b), UN (2022), zeb.research

Einordnung

- OECD-Länder mit teils deutlich **untersch. Systemen** – Anteil staatl. Leistungen und verpflichtender betrieblicher Rentenpläne bzw. kapitalgedeckter Systeme als **Hauptunterscheidungsmerkmale**
- **Nur verpflichtende Pläne oder kapitalgedeckte Renten** erhöhen indirekte bzw. direkte Kapitalmarktbeteiligung deutlich
- Hauptproblem für **staatlich dominierte Systeme**: Demografischer Wandel drängt zur privaten Altersvorsorge; in 2040 liegt das Verhältnis der 15–64- zu den über 65-Jährigen in DE bei nur noch 2,0 (FR: 2,1, IT: 1,6, JP: 1,5)
- Staatl. dominiertes System mit freiwilligen Zusatzrenten
- Staatl. Grundrente mit (verpflichtenden) Zusatzrenten
- Staatl. Rentensystem ergänzt durch kapitalgedeckte Renten
- Staatl. dominiertes System mit verpfl. Betriebsrenten

¹ <https://www.afme.eu/news/press-releases/details/new-afme--zeb-report-examines-role-of-capital-markets-in-germany>

² https://www.dai.de/fileadmin/user_upload/240515_Studie_Altersvorsorgedepots_Aktieninstitut_dwpbank.pdf

As the study shows, German households currently have relatively low levels of investments in shares and investment funds. Strikingly, assets in pension funds in relation to GDP are significantly lower than compared with international peers. The study indicates the following points:

- State pensions in Germany constitute more than three quarters (76%) of the income of pensioners, and occupational pensions constitute only 8%.
- Nearly 60% of household financial assets in Germany are in deposits or life insurance – the share of typical capital market instruments (bonds, pension funds, investment funds or equities) is significantly lower than in other markets.
- There are some examples of pension system changes in other countries (such as Sweden or Australia) which can provide evidence of how a market-based component can contribute to stabilisation of the pension system.
- Such a component can also have the effect of increasing direct or indirect retail participation in the capital markets.

Overview of the Deutsches Aktieninstitut study

The Deutsches Aktieninstitut study has a comprehensive analysis of retirement accounts (ie private pensions) in Australia, France, Ireland, Canada and the US.

Based on the analysis, the DAI proposes five key recommendations for action.

Enable investment in shares by waiving capital guarantees

The analysis showed that people saving with retirement savings accounts focus primarily on shares: The average share investments amount to 65 percent in the US, 55 percent in France and 49 percent in Australia. The high equity ratio results from the fact that there are no statutory capital guarantees or minimum interest rates. Capital guarantees require a high proportion of fixed income products, as these instruments have low volatility. Despite short-term fluctuations of stock prices, high share ratios lead to higher returns in the long term.

Legislation should therefore dispense with a capital guarantee or a minimum interest rate to promote higher investments in shares.

Enable a broad range of products from different providers without additional bureaucracy

In the countries considered, there is a variety of retirement savings accounts from many competing market participants. The providers are almost exclusively highly regulated financial institutions such as banks or insurance companies. An additional bureaucratic hurdle, such as the regulatory certification of retirement accounts or providers, does not exist in most of the countries analysed.

The European legislator should follow these examples and dispense with additional requirements.

Allow standard products and individual composition

Retirement savings accounts must be simple and easy to understand so that as many people as possible can use them. In the countries analysed, there is a wide range of standard products for retirement savings accounts provided by the private sector. In some cases, private providers are obliged by simple and easy-to-implement legal requirements to offer such a standard product.

In Australia, for example, the standard products ("MySuper") must either follow a simple investment strategy (for example a share component of up to 85 percent has emerged, supplemented by fixed-interest instruments and liquidity) or pursue a life cycle concept (this means an investment strategy in which the proportion of shares is adjusted to age and thus to the respective age-typical interests).

In other countries, for example the US or Canada, a market standard has developed independently of the legislator.

Savers who do not want to choose a standard product but want to select the financial products themselves should have this option.

Provide attractive tax incentives

Attractive tax incentives are necessary for the widespread use of retirement savings accounts. As a rule, the money saved in the retirement savings account can be deducted from taxes up to a maximum limit. This is an important factor for success.

In France, contributions to retirement savings accounts are deductible up to a maximum limit of 10 percent of taxable income. Irrespective of the amount of the contributions, at least EUR 4,399 and a maximum of EUR 37,094 per year can be deducted.

In Ireland, contributions for the retirement savings account, which are deductible, increase with age. For example, they amount to 15 percent over 30 years and 40 percent of taxable income over 60 years. The maximum amount of taxable income taken into account when calculating the percentage is EUR 115,000 per year.

In Canada, contributions to retirement savings accounts are taxable up to 18 percent of income with a cap of CAD 30,780 per year. Unused deductions are carried forward to future years and can be used later.

In the USA, deductible contributions of up to USD 6,500 are possible per year (and USD 7,500 from the age of 50 onwards).

Ensure flexibility in the payout phase

In the countries considered, the withdrawal plan is particularly popular because only the assets required for the respective period (e.g. one year, one month, etc.) are sold. With payout phases of around 20 years or more, at least part of the retirement assets remains invested in shares and thus continue to generate attractive returns.

There is no obligation to guarantee a certain pension income until the end of life (annuitisation) in the countries covered by the study. On the contrary, it has been shown that pensioners withdraw money so carefully that their savings are not used up during their retirement. As a result, four out of five of the countries surveyed have introduced minimum annual withdrawal requirements, in order to generate tax revenues (the money taken from pensions is typically taxable).

The flexibility to choose a payout plan without mandatory annuitisation should also be part of European legislation.

What are the options for Germany?

First pillar

In relation to the first pillar, the zeb study indicates that the addition of a market-based component can help to stabilise the German state pension system. Germany could, similar to Sweden (see graph below), establish a fund that invests on a long-term basis in capital markets.

The German government has proposed such a fund (the Generationenkapital fund) under which the government would invest 12bn euros per year until 2035 in a state-managed fund, which would grow to around 200bn euros. The income from the fund would then be used to help stabilise the state pension in the future.

The proposals were agreed by the Government in 2024, but we understand that the Regierungsentwurf is unlikely to be taken forward in this parliament.

We recommend that the proposals are re-introduced early in the next Parliament in 2025.



Beispiel Schweden: Aufgrund von Änderungen im staatlichen Rentensystem stieg der Anteil der privaten Anleger in den Jahren danach deutlich an

Rentensystem und private Aktienkultur in Schweden

Deep Dive

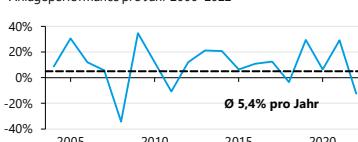
Eckdaten 2022



- Bevölkerung: 10,5 Mio.
- Anteil über 65 Jahre: 20,4%¹⁾
- Merkmale des Rentensystems:
 - Staatl. Rente: Mischung aus Umlageverfahren und staatl. oder privatem Kapitalgedeckten System²⁾
 - Hoher Anteil an Betriebsrenten

Staatliche Rentenkasse („Tilläggs pension“)

Anlageperformance pro Jahr 2000–2022³⁾

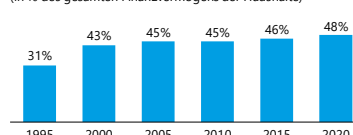


- Eingeführt in 2000 als Teil einer grundlegenden Änderung des Rentensystems⁴⁾
- Beitragsstruktur: 2,5% des Renteneinkommens (18,5% des Gehalts)
- Verwaltetes Vermögen: 75 Mrd. EUR⁵⁾
- Besteht aus mehreren Teilfonds, z. B.:
 - „AP7 Equity Fund“: Anlagen in globales Aktienportfolio⁶⁾
 - „AP7 Fixed Income Fund“: Anleihen

Referenz: MSCI All Countries World Index, d. h. ~2% des Vermögens sind in ~40 dt. Unternehmen investiert

Aktienkultur

Finanzanlagen der Privathaushalte in Aktien & Investmentfonds (in % des gesamten Finanzvermögens der Haushalte)⁷⁾



- Auswirkung Pensionsfonds und Änderung des Systems: deutlicher Anstieg der priv. Invest. in Aktien/Investmentfonds ab 2000
- Notwendigkeit eines Systemwechsels im Rentensystem (von umlagefinanziert zu kapitalgedeckt) hat Offenheit für Kapitalbeteiligungen priv. Anleger gefördert
- Zusätzl. kultureller Aspekt: Mitarbeiterbeteiligungsprogramme in Schweden sehr beliebt

1) Deutschland: 22,1%; 2) Privatpersonen haben die Wahl zw. Investitionen in zertifizierte private Fonds oder staatl. Fonds; 3) Anlageperformance ohne Beiträge und Auszahlungen; 4) Anteil der Bevölkerung >65 J. im Jahr 2000: 17,2%; 5) Für weitere Informationen inkl. Zahlen zu Performance, Beiträgen und Auszahlungen, s. Sunde AP-fonden (2023); 6) MSCI All Countries World Index als Referenz; zusätzl. ausgewählte Unternehmen, die aufgr. sozialer oder staatl. Kriterien aus dem Portfolio ausgeschlossen wurden (Waffenhersteller, Arbeitsrechte...); 7) Anteil am gesamten Finanzvermögen gemäß Analyse auf der ersten Seite von These D; Quelle: Mercer (2022), OECD (2023a, 2023b), SCB (2023), Sunde AP-fonden (2023), zeb.research

Second pillar

In relation to the second pillar, it is noteworthy that in Germany, only 8% of pension income comes from occupational pensions, whereas in the UK the figure is 28%.

This indicates that there is potential for occupational pensions to play a greater role in Germany, to provide more citizens with an additional pension.

This could be enhanced by an auto-enrolment system that would enhance participation from the outset ³.

We note that this fits into a wider debate on pensions at European level. For example, the Eurogroup statement from March 2024 has a section on pensions, which includes an invitation to Member States to assess the availability of products for their citizens on the occupational pension schemes market and share best practices. It also invites the European Commission to review and consider whether to further develop and improve the pan-European pension product. Similarly, ESMA has recommended that the European Commission and member states should examine the contribution which a revived Pan-European Pension Product or other pan-European long-term savings and investment products could make to EU capital markets. We suggest that Germany plays an active role in these initiatives, both contributing to the European-wide initiatives and exchanging ideas on best practices with other countries.

Third pillar

In relation to the third pillar, the DAI study indicates that the design of private pension products is critical to ensuring that the products are attractive for citizens to invest in, and for product providers to offer.

The key success factors identified in the study are:

- The absence of a guarantee enables a larger percentage of the account to be invested in equities in order to generate long-term returns, while balancing the risk (experience in Germany has shown that if a guarantee is required, then the product provider will typically not invest in equities, and therefore the product will not be able to generate long-term returns, and therefore will not meet the expectations of citizens)
- There is a broad range of products, provided mainly by highly regulated financial institutions, so no further bureaucratic hurdles are necessary
- The accounts are simple and easy to understand
- There are tax incentives to encourage citizens to invest

³ In the UK, the introduction of an auto-enrolment pensions system has boosted occupational pensions participation to nearly 80% of employees (from around 50%).

- There is flexibility in the payout phase – citizens can choose to purchase a lifelong pension, or gradually withdraw funds as needed, so that some funds continue to be invested and therefore to generate attractive returns. The evidence is that citizens who choose the drawdown option tend to do so carefully.

The lessons learned from other countries with significantly advanced pension systems can be successfully applied in Germany.

It is worth noting that the majority of citizens in Germany have a first pillar state pension, which already provides them with guaranteed income.

Those citizens might decide that they also want to have additional amount of guaranteed income from their private pension. In that case, they can choose to buy an annuity. The product provider would then switch investments out of equities and into other investments such as bonds after the initial savings period (Ansparphase).

On the other hand, those citizens might decide that they do not need to buy an annuity, and would prefer to withdraw funds gradually as needed, noting that they are already receiving the first pillar state pension. In that case, a small proportion of the investments would be sold, and the rest would continue to be invested. This enables citizens to continue generating long-term returns to finance their retirement, and is also positive from the perspective of the businesses in which the investments are held. In addition, the citizens who generate long-term returns in their retirement will have increased disposable income, which is likely (in particular as they get older) to be used in their local economy.

We understand that some commentators expressed concerns during the pre-consultation phase that perhaps a small minority of citizens would not make responsible financial decisions about their private pension, and that in order to protect such citizens, it should be compulsory for all citizens to purchase an annuity. We think that the societal risk that some citizens might not make responsible financial decisions can be substantially mitigated by two factors. First, there is the protection afforded by the first pillar state pension. Second, the government can aim to enhance financial literacy by implementing a National Strategy to improve citizens' competences on long-term financial planning, overall financial resilience and well-being. The joint initiative from the BMF and the BMBF is a very positive step in this direction⁴.

Based on the above analysis, we are supportive of the proposals in Germany for changes to the Altersvorsorgedepot, set out in the Referentenentwurf. The intention was for the government to

⁴ <https://www.bundesfinanzministerium.de/Content/DE/Pressemitteilungen/Finanzpolitik/2024/09/2024-09-24-oecd-vorschlag-finanzbildungsstrategie.html>

prepare a Regierungsentwurf, but we understand that this is unlikely to be taken forward in this parliament. We recommend that the proposals are re-introduced early in the next Parliament in 2025.

Summary of recommendations for the next parliament

- State pension – stabilise the pension system by investing in a fund (for example, the Generationenkapital fund)
- Occupational pension –consult on introducing auto enrolment schemes at national level and contribute to the assessment of products at European level
- Private pensions – take forward changes to the Altersvorsorgedepot as set out in the Referentenentwurf. In particular, (1) remove the requirement for a guarantee, thereby enabling the account to be invested substantially equities in order to generate long-term returns, (2) allow citizens to choose between drawdown and annuity.