The Pension Scheme of the European Union

Table of contents

The Pension Scheme of the European Union (PSEU) – Executive Summary

Legislative background

Article 14 of Protocol No 7 on the Privileges and Immunities of the TFEU provides that "The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure and after consultation of the institutions concerned, shall lay down the scheme of social security for officials and other servants of the Union". Within that framework, the Pension Scheme is founded on the Staff Regulations (SR), notably Articles 83 and 83a as well as Annex XII of those Regulations as regards the funding aspects of the scheme.[1] These provisions, first applied with the SR of 1962, constitute the legislative basis for the funding and operation of the PSEU and the maintenance of its financial balance.

Article 83 of the SR provides that:

-the benefits paid out under the scheme are charged to the EU budget;

-the Member States jointly guarantee the payment of such benefits;

-staff contribute one third of the cost of financing the scheme.

Article 83a and Annex XII of the SR set out the principles and the detailed actuarial rules for computing the contribution rate required to guarantee the financial balance of the scheme.

The benefits paid out under the scheme are set out in Chapter 3 of Title V (Articles 77 – 85a) and in Annex VIII of the SR and include retirement pensions to former officials, their survivors and those in receipt of invalidity allowances. Following the Reforms of the SR introduced in 2004 and 2014, Section 4 of Annex XIII of the SR sets out transitional arrangements for the pensions of officials, depending on their date of recruitment to the service and/or their date of retirement.

Nature of the pension fund

The PSEU is not a "pay as you go" scheme but operates as a notional or virtual fund, with defined benefits, protected by the principle of acquired rights. There is no actual investment fund into which contributions are placed. Instead it is considered that the contributions which would have been placed in such a fund are invested in the long-term bonds of the Member States and reflected in the pension liability, with the Member States guaranteeing the payment of pension benefits, as laid down by Article 83 of the SR. This guarantee applies even in the absence of an EU budget or if the EU itself were no longer in existence. The existence of this guarantee and its recognition by all Member States has been acknowledged in Article 135(2) of the draft Withdrawal Agreement of March 2018 between the EU and the UK which stipulates that after Withdrawal, the United Kingdom will contribute its share of the Union liability for the pension and other employee benefits rights accrued on or before 31 December 2020. The payments linked to this liability will be transferred when the deadline for these amounts is due or the liability may be discharged at an earlier stage based on actuarial valuations, drawn up according to specified international accounting standards.

The method of determining the contribution rate for staff and the implied rate for employers on the basis of the future cost of pensions has meant that in the initial years of the PSEU when the EU was an expanding organisation with relatively young staff, the contributions attributed to the notional fund far outweighed the level of actual pension expenditures in those early years. The mechanism under which the funds for the PSEU are retained in national treasuries (in effect, a loan by PSEU members to the

[1] See Annex I: Extracts from the Staff Regulations (Regulation No 31 (EEC) 11(EAEC) of 1.1.1962, as last amended by Regulation (EU, Euratom) No 1023/2013) of 22.10.2013.

Member States) has therefore meant a substantial increase in the Member State's liquidity, amounting to some tens of billions of euro. In effect, the EU budget borrows money from the members of the scheme in return for the guarantee by the Member States to pay future benefits. Moreover, by attributing the contributions in this way rather than investing them in a distinct fund on the capital market, the notional fund is shielded from all the risks and vagaries which can afflict the capital markets threatening the solvency of pension funds, such as occurred in the 1920's and 1930's and more recently, during the financial crisis which commenced in 2008, still evidenced by continuing low interest rates. Indeed, it can be said that the PSEU has the features of a scheme organised on the basis of the solidarity principle, as underlined by the CJEU in point 134 of its Judgment in Case T-135/05.

Unlike most of the schemes which operate in the Member States for public officials, where pension contribution rates or benefits are adjusted with the aim of achieving balance between the annual amounts raised from contributions and the annual amounts of pension expenditures, the contributions to the PSEU serve to finance the future pensions of EU staff. The total pension contribution is fixed at a level to cover the predicted cost of the pension rights acquired by officials during a given year (the service cost) and is not at all linked to actual pension expenditure in that same year. The one-third share of the service cost representing the staff contribution is applied as a percentage deduction from the basic amount of monthly salaries of each active official. Balance is assured by varying the annual rate of contribution to the scheme and, where relevant, through adjustment of the pensionable age.

Actual expenditure on pensions for any given year is met from the annual budget. Staff contributions for that year - one-third of the service cost- are booked in the budget as receipts and therefore form part of own resources.

On 31 December 2016, there were about 84 500 contributory and non-contributory members of the PSEU, of which just over 61 000 were active staff and about 23 500 were non-active (retired officials, survivors and those on invalidity).

Annual updating of contributions

The permanent maintenance of the balance of the PSEU notional fund is assured through its periodic actuarial assessment, as if a real fund existed. The assessment, which is checked by independent external experts, is comprehensively evaluated by Eurostat every five years and updated annually. The actuarial balance principle is at the heart of the assessment, so that the acquired rights of officials to the future pensions that they will receive after retirement are evaluated at their present value, using a real discount rate (RDR) for the long-term debt of the Member States, measured by means of a moving geometric average interest rate (over the preceding 22 Years for 2017 but which will move in annual stages to reach 30 years as from 2021). For the 12-month period from 1.7.2017, this average real discount rate is 3.1%[2]. The rules set out in Annex XII of the SR provide that, in addition to the RDR and the regulatory framework provided by the SR, the annual evaluation includes the updating of other factors such as demographic parameters based on changes in the numbers of staff and pensioners, expected general salary growth, individual salary progression, mortality, retirement age, staff turnover, marital status and prospects for survivors. In the annual update, the pension contribution rate for officials (PCR) is adjusted if the new assessment shows that the calculated rate required to ensure actuarial balance differs by at least 0.25 % points from the rate currently in force. As pension levels are linked to the salary scale for officials, these move in line with the annual adjustments designed to ensure the parallel movement with the average real net remuneration of public officials in the Member States, resulting from the application of the Method. Based on the Eurostat assessment and the

[2] Resulting from an average Nominal Discount Rate of 4.8% for 1995-2016 and an average Inflation Rate of 1.7% over the same period.

provisions of the SR, the PCR is fixed by the Commission each year, normally in December, with retroactive effect from 1 July of the same year.

For the 12-month period from 1.7.2017, Eurostat has assessed the service cost for pensions at around €1 343 million and expected salaries at about €4 575 million. The service cost therefore corresponds to 29.3% of the salary bill, which leads to a PCR for officials for this period of 9.8%.

Whilst Article 113 of the SR requires the Commission to assess the functioning of these Regulations as a whole by the end of 2020, Article 14 of Annex XII of the SR specifies that in 2022, the Commission shall submit a report to the Parliament and Council regarding the budgetary implications of the arrangements for assessing the actuarial balance of the PSEU contained in Annex XII and, if appropriate, submit a proposal for amendment. An interim report is to be submitted in 2018.

The pension liability

Each year, based on the situation for the preceding December, Eurostat establishes the PSEU liability, termed the Defined Benefit Obligation (DBO), representing the balance between the amounts of the contributions that have been assigned to the scheme and the pensions which have been paid out to beneficiaries. The remaining future benefits represent a liability (DBO) which is determined on an actuarial basis, by discounting to their present value the estimated future cash flows attributed to past services by the end-year reference population of PSEU members (officials and former officials, including survivors) using a real discount rate (RDR) for this purpose. For each year concerned, the practice is to use as the RDR the spot nominal interest rate at the end of December for government bonds with a maturity approximating to the term of the related pension liability, taken to be 20 years, deflated by the expected long-term average inflation rate, also measured over 20 years. For 31.12.2017, with a RDR of 0.4%, the DBO of the PSEU has been assessed at about €65 668 million[3](including the pension schemes of High Office Holders), compared to about €41 949 million at the end of 2013 when the RDR was 1.8%. Although part of the increase over this period is a reflection of the increase in the number of PSEU members, the size of the latest figure for the DBO is due in large part to the use of the low nominal spot rate recorded at the end of 2017. End December rates can vary significantly from year-to-year and heavily influence the size of the RDR; it is highly improbable that current low interest rates will prevail throughout the period when the DBO will be discharged (60 years or more). By contrast, the long-term RDR used in the assessment of the PCR for the period from 1.7.2017 (average over 22 years) stood at 3.1%, which would be a much more realistic and more stable basis on which to assess the pension liability. Eurostat has estimated that a 0.1%-point change in the RDR leads to a variation in the DBO of around €1 500 million.

Up to and including 2004, the general accounts of the EU registered a provision for the acquired pension rights of officials on the liabilities side of the accounts and a debt of the Member States of the same amount on the assets side, representing the guarantee to pay future pensions (some €25 800 million for 2004). However, following a decision of the Commission's Accounting Officer, this debt has no longer appeared on the assets side since 2005. Whilst this removal from the assets side does not diminish in any way the legal guarantee by Member States to pay future pensions as set out in Article 83 of the SR and confirmed in the draft EU-UK Withdrawal Agreement, it leads nevertheless to the confusing appearance of a large deficit in the balance sheet and has been criticised as being incorrect and not in line with recognised international accounting standards. The Court of Auditors, in its report of 31.10.2006, stated that by removing this debt, the Commission had not respected its own new accounting rules (Accounting rule No 12). The Accounting Officer's decision has also been the subject of seven critical resolutions by the European Parliament during the period 2007-2014. It would be

[3] Consolidated Annual Accounts of the EU for 2017 (Com (2018)52 final of 27.6.2018).

desirable to reinstate the debt to the assets side of the balance sheet of the general accounts, avoiding the present ambiguity and confusion.[4]

Fuller details on the funding and operation of the PSEU can be found in articles published in VOX[5], whilst summary explanations on the financing of the scheme have also been published by AIACE in 2017[6].

Conclusion and AIACE position

-the PSEU as defined in the SR assures permanent actuarial balance; the contributions of staff and the employer cover the future pension rights; their placing in a notional fund, in effect in the public debt of the Member States, has considerably improved the liquidity of the latter's treasuries; the fund is protected from the vagaries of the capital markets; the Member states guarantee the payment of the pensions of each individual when these fall due. There is therefore no necessity to amend the SR as regards the PSEU;

- the current presentation of the pension liability in the general accounts of the EU should be modified in order to include the pension debt of the Member States on the assets side of the balance sheet; the explanatory notes to the accounts should show the present value of the pension debt, calculated on the basis of the average multi-annual interest rate used for the determination of the PCR[7].

- in an independently verified study of 2016 published by the Commission on the long-term budgetary implications of pension costs[8], carried out in the context of the substantial budgetary savings resulting from the 2014 Reform of the SR, Eurostat has confirmed that through the regular updating of the actuarial assumptions and parameters laid down by the SR, regular adjustments to the PCR and, where relevant, pensionable age, ensure balance of the PSEU from one year to another and the continued viability of the regime. Indeed, it is the logical, mathematical consequence of the aforesaid budgetary savings that the PCR required to maintain balance has fallen in recent years – from 11.6% for 2010 to 9.8% for 2017.

Despite this confirmation, the Council, in its Conclusions of 19 December 2016 on the Eurostat study, expressed its preoccupations concerning the future development of the PSEU, especially its budgetary cost which it insisted should be reduced and called on the Commission to propose appropriate measures to assure the continued viability of the regime[9]. If the Commission were to accept this demand, it would involve either a violation of the acquired rights of officials and pensioners or further reduce the career and pension prospects of future staff, in a context where the Reforms of 2004 and 2013 have already adversely affected the attractiveness of the European civil service, both globally and

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[4] For further explanations, see Annex II a: "Our Pension Fund" by Marc Oostens, AIACE 2018 and Annex II b: "Accounting for Member States' commitment to reimburse staff pension contributions" by Marc Oostens, AIACE 2018.

[5] See Annex III a : « Le régime de pensions des fonctionnaires et autres agents de l'UE – Origines caractéristiques, et arguments en faveur de sa continuité- » par Ludvig Schubert, VOX No 86 – Novembre 2010 ; and Annex III b : « Notre régime de pensions revisité » par Ludwig Schubert, VOX No 102, Mars 2016.

[6] See Annex IV a : « Le régime de pension du personnel statuaire de l'UE », AIACE, 72/17,4.9.2017 and Annex IV b : « Short explanation of how the EU pension scheme is funded », AIACE, 73/17,4.9.2017.

[7] These points have been further developed in the letter from AIACE to Mrs Souka of 24.7.2018 (Annex V a); see also the letter from DG HR of 24.9.2018 in reply to the AIACE letter of 24.7.2018 (Annex V b).

[8] See Annex VI: Commission Staff Working Document- Eurostat Study on the long-term budgetary implications of pension costs. (SWD (2016)268 final of 28.7.2016).

[9] See Annex VII: Council conclusions of 19.12 2016 on the Eurostat study of 28.7.2016 (doc 14834/16 – draft conclusions of Coreper of 25.11.2016, adopted as an 'A' point by Council).

as regards the geographical balance of officials' origins. These points have been further developed by AIACE in recent correspondence with the Commission.[10].

-it has been suggested that the current actuarial-based PSEU, backed up by the Member States' guarantee specified in Article 83 of the SR, could be replaced by a "capitalised" fund. However, such a fund would be subject to all the vagaries of the financial markets and its creation would require Member States to mobilise billions of euro which they currently hold in their own public debt, a move which would seem highly unlikely on their part.

In footnote 18 of the recent communication concerning the MFF 2021-2027[11], it is stated that: "Within the context of the re-examination of the Multi-annual Financial Framework in 2023, the Commission will undertake a reflexion on the feasibility of creating a pension fund for the staff by capitalisation."

In the past, in responding to requests from Parliament and Council on this subject made in the 2008 Discharge, the Commission stated that:

"The European Communities Pension Scheme is defined in the Staff Regulations. When in 2003, the Commission presented a proposal amending the Staff regulations, due consideration (backed-up by a complex actuarial study) was given to setting up a pension fund. However, the analysis did not conclude in favour of such a change. Initial set-up costs as well as risks of losses by the fund due to the investment climate and policy would be particular concerns. The Commission considers that the hypotheses of this analysis have not changed and therefore that the conclusions remain valid."[12]

Furthermore, in a Report to the Council in 2012,[13] the Commission carried out an analysis of the PSEU, undertaken in the context of the 2011 proposals to further amend the SR. That analysis confirmed the actuarial principles of the PSEU, underlining that when an official retires, the consequent new expenditure on his pension has already been paid for, in the form of the contributions paid during that staff member's period of service. Moreover, as well as making a positive assessment off the PSEU compared to national pension schemes, the Commission Report examined in some detail the effects of the possible creation of an actual pension fund, pointing out that the transfer of the whole of the liability of the PSEU notional fund to an actual fund "would involve enormous cost" in the first year, whilst other options for an actual fund to be limited to either the pension rights of newly-recruited staff or to the new rights of all staff would also involve high costs in the short to medium term.

[10] See Annex VIII a: Letter from AIACE to Mr Oettinger of 29.1.2018 and Annex VIII b: Reply of Mr Oettinger of 10.4.2018.
[11] Com (2018) 321 final (SWD (2018) 171) of 2.5.2018.
[12] Page 4 of the Report from the Commission to the European Parliament and the Council on the follow-up to the Discharge for the 2008 financial year (Summary); (Com (2010)650 final of 18.11.2010, (SEC (2010)1438)).
[13] See Annex IX: Report from the Commission to the Council on the Pension Scheme of European Officials and other Servants of the European Union (Com (2012)37 final of 7.2.2012.

History and background of the EU Pension Scheme

When the European Coal and Steel Community (ECSC) was established in 1952 under the Treaty of Paris, with a duration of 50 years, a fund was set up for the officials of its High Authority to guarantee their pension rights, with staff paying one-third of the total contribution and the ECSC's budget being responsible for the remaining two-thirds. This fund was placed on the capital markets.

With the creation of the European Economic Community (EEC) and Euratom in 1958, under the Treaties of Rome, the accompanying Staff Regulations which entered into force in January 1962, set out the conditions for the salaries, pension and other social security arrangements for the personnel of these institutions. Given the unlimited duration of the Rome Treaties, it was decided that both the employer and staff contributions to the pension fund could be kept within the budget and not placed within a separate fund on the capital markets. Instead, contributions based on the actuarial evaluation of future pension commitments would be assigned to a notional fund, backed up by a legal guarantee by the Member States to pay these pensions when they would fall due. Such a system, which saw employee contributions treated as a source of receipts for the budget whilst the employer's contributory share was retained by the Member States, had clear advantages in terms of substantial budgetary savings, especially in the initial period of the scheme when few officials were reaching retirement age and actual pension expenditures were consequently low.

With the merger of the executive branches of the three institutions of the European Communities (ECSC, EEC and Euratom) in 1967, the pension rights of ECSC staff and of those already retired from this organisation were incorporated into the pension scheme of the two other institutions. The funds of the ECSC scheme were disbursed, being used for the construction of housing for workers in the coal and steel industries (employer share of the fund) and for appropriations for housing assistance for European Communities staff (employee contribution).

The changes to the Staff Regulations of 2004 introduced a number of significant changes to the benefits side of the Pension Scheme. These changes, influenced by increases in life expectancy and the tendency amongst the Member States to raise the minimum retirement age applicable to their own national schemes as well as by budgetary considerations, included the following:

-an increase in the minimum retirement age from 60 to 63 for those officials recruited as from 1 May 2004;

-an annual accrual rate of 1.9% for those recruited from 1 May 2004, instead of 2.0%, meaning that 36.8 years of acquired pension rights would be needed to reach the maximum pension of 70% of final salary, instead of 35 years previously;

-adjustments to the pension rights bonus for years worked after the minimum pensionable age;

- changes to the staffing structure, involving a lowering of salary scales including lower entry-level salaries, new conditions for promotions and the more widespread replacement of officials by contract agents. These measures combined to limit the level of the final salaries on which pensions are based.

In a Report of 2010 (SEC (2010) 989 final), the Commission, based on the work of Eurostat, estimated that compared to the pre-existing situation, the 2004 Reform would achieve steadily rising annual budgetary savings on pensions expenditure during the period 2010-2059 which would reach €1 047 million (at constant prices) by 2059. Total cost savings for the whole of the 50-year period were put at €24 785 million.

The further Reform of the Staff Regulations of 2013, which entered into force on 1 January 2014, introduced additional changes with an impact on the pension scheme and its costs, in particular:

-a new minimum pensionable age of 66 years (instead of 63) for those recruited as from 1 January 2014;

-further reduction of the annual accrual rate to 1.8% (instead of 1.9%) for those recruited from 1 January 2014, meaning that 38.9 years of pension rights are required for these staff to reach the maximum pension of 70% of final salary;

-the freezing of staff salaries for 2013 and 2014, through the non-application of the Method for those years;

-further changes to the career structure for staff.

The Eurostat study of 28.7.2016 on the long-term budgetary implications of the 2013 Reform on pension costs demonstrated that expenditures on pensions would peak in 2046 and steadily decline each year thereafter. The annual budgetary savings resulting from that Reform would rise progressively year-by-year to reach €642 million (constant prices) in 2064. Over 50 years, the savings would total €19 230 million[14].

It should be noted that the savings on pensions introduced by the Reforms of 2004 and 2013 have been mainly at the expense of the most recently recruited staff.

National pension schemes for Member State civil servants

Regular surveys are undertaken by Eurostat through questionnaires to delegations in order to identify the main features of national pension schemes for permanent, statutory staff working in central government. On the basis of the latest survey conducted in the early part of 2018, Eurostat has reported on the main characteristics of such schemes:

For the most part, these are of a “defined benefit type, are unfunded in the sense that contributions are not transferred to a specific fund (although a minority of Member States operate “defined contribution” schemes or hybrid schemes) and vary widely in terms of the relative shares of employer and employee contributions, with the employee contribution as a proportion of the total ranging from 0% for a few Member States to 50% or more in a limited number of cases. The majority of Member States operate their pension arrangements as “pay-as-you-go” schemes under which the benefits of current pensioners are financed by contributions linked to the earnings of current employees, whilst in some Member States the budgetary method is used. The contribution of employees is usually calculated as a percentage of the base salary, ranging from 0% in a few cases to more than 15% for a few others; for most Member States, the rate is typically between 5% and 12.4%. The updating of the contribution rate is in general a matter for ad hoc political decisions, taken at irregular intervals.

According to Member State, there are wide variations in the maximum and normal pensionable ages and in the methods for computing the pension, including indexation. Some Member States provide for the option of a lump sum payment on retirement in return for a lower monthly pension.

The full Eurostat report for 2018 (“Survey results on central government pension schemes in the EU”) is contained in Annex X.

[14] See Annex V (op cit)

Glossary of acronyms and abbreviations

CJEU: Court of Justice of the European Union

DBO: Defined benefit Obligation (Pension liability)

DG HR: The Directorate-General for Human Resources of the European Commission

ECSC: The European Coal and Steel Community

Eurostat: The Statistical Office of the European Union

MFF: The Multi-annual Financial Framework

PCR: Pension Contribution Rate (applied as a percentage deduction from the monthly basic salaries of staff and those on invalidity)

PSEU: The Pension Scheme of the European Union

RDR: Real Discount Rate (derived by deflating a nominal discount rate (interest rate) by an appropriate inflation rate)

SR: The Staff Regulations of Officials of the European Union

TFEU: The Treaty on the Functioning of the European Union

VOX: The official periodical (3- 4 issues each year) of the International Association of Former Officials of the European Union (AIACE)

List of Annexes

Annex I: Extracts from the Staff Regulations concerning EU pensions.

Annex II a : « Our Pension Fund », Marc Oostens, AIACE, 2018.

Annex II b: « Accounting for Member States' commitment to reimburse EU staff pensions contributions », Marc Oostens, AIACE, 2018.

Annex III a : « Le régime de pensions des fonctionnaires et autres agents de l'UE- Origines, caractéristiques, et arguments en faveur de sa continuité- », Ludwig Schubert, VOX No 86, Novembre 2010.

Annex III b : « Notre régime de pension revisité », Ludwig Schubert, VOX No 102, Mars 2016.

Annex IV a : « Le régime de pension du personnel statuaire de l'UE », AIACE 72/17, 4.9.2017.

Annex IV b: "Short explanation of how our pension scheme is funded", AIACE 73/17, 4.9.2017.

Annex V a: Letter of 24.7.2018 from AIACE to Mrs Souka, Director General of DG HR.

Annex V b: Letter of 24.9.2018 from Mr Roques of DG HR, in reply to the AIACE letter of 24.7.2018.

Annex VI: Eurostat study on the long-term budgetary implications of pension costs (SWD (2016)268 final of 28.7.2016).

Annex VII: Conclusions of the Council of 19.12.2016 on the Eurostat study on the long-term budgetary implications of pension costs (Doc. 14834/16).

Annex VIII a: Letter of 29.1.2018 from AIACE to Commissioner Oettinger.

Annex VIII b: Letter of 10.4.2018 from Commissioner Oettinger, in reply to the AIACE letter of 29.1.2018.

Annex IX: Report from the Commission to the Council on the Pension Scheme of European officials and other Servants of the European Union (Com (2012)37 final of 7.2.2012).

Annex X: Survey results on central government pension schemes in the EU, Eurostat, 2018.