The Mediterranean: Pensions in crisis

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Pension reform proposals have been put forward, writes Roxane McMeeken. The trick will be to implement them amid the current political and economical chaos

Following the inconclusive general election on 6 May, politicians scrambled unsucessfully to form a coalition government amid hot weather in Athens and frenzied debates on television – interrupted only by the lighting of the 2012 Olympic flame in Olympia in an elegant ceremony. Fresh elections will now take place on 17 June.

Pensions were understandably nowhere near top of the political agenda as the coalition talks foundered and fresh elections loom. Yet, with state pension costs set to hit an eye-watering 24% of Greek GDP by 2060, according to European Union, the parlous state of the retirement system is one the key causes of the country's dire political and economic predicament.

While some reform of the Greek retirement system has been achieved in recent years, further changes are urgently required if the country is ever to get back on its feet.

Some 98% of Greek pension plans are provided and guaranteed by the state, based on a pay-as-you-go, mandatory system. A solely first pillar system may sound simple but it is, in fact, a multi-headed beast, comprising 13 'main' and a plethora of 'auxiliary' funds. The supplementary funds once stood at 133 but are increasingly being merged, albeit to varying degrees, to around 40 funds. John Fourlis, executive director of Greek asset manager Alpha Trust Investment Services, says: "The scheme has a fragmented structure, which comprises a number of different parameters, many times even within the same pension fund."

There are variations based on age group, gender, type of payout (one-off versus regular payouts), type of fund (basic and auxiliary), occupation, different classes within each occupation and type of legal entity. Fourlis says: "The structure is complicated due to the many exceptions the system has adopted for different groups over the years whilst administrative inefficiencies and lack of proper investment management practices have added to the complexity."

The system is clearly unsustainable. In a country in its fifth year of recession, state pension costs are already 12.5% of GDP and rising rapidly. The average dependency ratio is 1.7 workers per pensioner, according to Alpha Trust, That ratio is well below the 2:1 that is seen as viable, much less the 3:1 required to be healthy.

Compounding this, the small pool of reserves held by Greek pension funds – which stood at around €25bn before the financial crisis, according to EDEKT Asset Management, a Greek asset manager – is invested almost solely in domestic sovereign bonds. Nicholas Tessaromatis, chief executive of EDEKT, says: "This heavy investment in Greek government bonds was seen as very low risk, but this has, of course, turned out to be extremely ironic." The 60% haircut on Greek government bonds and their plummeting value means the pension funds have lost around 80% of their value, says Tessaromatis.

Despite this, some important reforms have been achieved in the past two years, under pressure from the providers of Greece's bailout, the European Union, European Central Bank and International Monetary Fund. A major pensions reform law was passed on 9 July 2010 – while the sixth general strike against austerity of that year paralysed the country – and this was followed by additional bills, with the latest on 13 February this year.

These reforms, which are due to be fully implemented by 2018, have increased the average minimum retirement age from 60 to 65 for both men and women, curbed widespread early retirement under 60 and cut pensions. Pensions have also been switched from a calculation based on employees' highest wages to one based on average lifetime earnings. Meanwhile, the 13 main funds are to be streamlined into three, for public and private sector workers, for the self-employed and for farmers.

The February bill, passed as a violent protest took place outside the Greek parliament, introduced key measures such as financial penalties for early retirement. These aim to raise the effective average retirement age to 63.5 years by 2015 from 61.4 at present.

A further 12% was cut from pensions exceeding €1,300 a month. Important tweaks were also made. For example, unmarried or divorced daughters of civil servants, bank employees and military staff (aged over 18) are no longer entitled to their deceased parents' pensions.

As encouraging as these steps are, a huge amount remains to be done. Platon Tinios, assistant professor at Piraeus University, is a pensions expert. He says: "The recent reforms go in the right direction but they don't go far enough and a number of issues remain unsolved."

The lack of a second and third pillar system remains Greece's biggest problem. While a legal framework for both occupational and private pensions is in place, the absence of tax incentives for paying into such schemes has meant that they have failed to get off the ground. Fourlis says: "Although [it could be argued] that the tax incentives will carry a significant fiscal cost at a very bad time for the public finances, it is necessary to find a balance between the two and start a transition towards a multi-layered system."

Tessaromatis believes that the state may step in, although not exactly with tax incentives. He says: "As contradictory as it sounds, the ministry of social security is thinking about cutting contributions to pension funds, according to press reports. The idea would be to encourage people to look beyond the state for retirement provision."

More significantly, the February 2012 reforms state that each auxiliary fund must either change into an occupational scheme or club together with their peers to form a single auxiliary fund. The enlarged fund would enjoy the benefits of economies of scale but, crucially, it would not be supported by the state.

The funds have until July 2012 to decide, with the idea being that the funds opting to become occupational schemes would be up and running by 2013. Tessaromatis says: “The level of enthusiasm among the funds for becoming occupational depends on their financial situation. I understand that a few funds have surpluses, so these may take the occupational route.”

A number of other problems must be tackled too. Brigitte Miksa, head of international pensions at Allianz Global Investors, says: “Although the legal retirement age has increased there are so many special programmes for early retirement that the reform is having little effect. All these little holes in the legislation must closed up.”

The social security system is still wide open to scams due to lack of full computerisation. The Greek press regularly uncovers benefit fraud, often on a surprising scale. In a recent case, for example, it was reported that the authorities were investigating the people of Zakynthos after discovering that some 1.8% of the island’s population were claiming benefits for blindness. Suspicions were aroused when it emerged that the level of blindness was nine times more common on the island than on the mainland.

Panagiotis Zampelis, managing director at Aon Hewitt in Athens, says: “The fact that many records are still on paper means that cross-referencing is difficult. This has allowed huge numbers of people to claim pensions illegally. For example, people claim pensions of the deceased. No significant measures have been taken to address this so far.”

Despite the positive steps that have been taken to reform the Greek pension system, a huge amount remains to be done, from developing the second and third pillars, to rationalising the existing system. For these steps to be taken effectively, Greece first needs some sort of political peace. Tinios says: “A stable government is critical for the pension system.”