Original Research Article

Comparative Analysis of the Third Pillar Pension Policies in Europe, America and Other Developed Countries and Implications for China

Xiao Zheng

State Information Center, Beijing , Xicheng District, No. 58 Sanlihe Road, 100045

Abstract: The third pillar pensions in China represent a critical mechanism for significantly expanding the pension system and optimizing its structure in the forthcoming period. Developed nations, such as those in Europe and North America, have proactively advanced the third pillar pensions to address demographic aging, utilizing policies that actively incentivize participation, ensure value preservation and growth of assets, and strengthen operational oversight. Hence, it is advisable to draw on the policies of third pillar pensions in these nations to diversify forms of participation, extend benefits to broader groups, enhance market entry conditions for sustained value growth, and standardize industry development to secure fund safety.

Keywords: Third pillar pensions, comparative analysis and implications

The pension security system is a safety net for people's lives and a stabilizer for social operation. The pension insurance system can provide stable pension income, solve the living difficulties of some retirees, and alleviate the pressure of social assistance. Pension insurance can improve the consumption ability of the elderly, promote domestic demand growth, and drive economic development. Pension insurance can also provide various medical and welfare services for the elderly, safeguard their basic rights and interests, improve their quality of life, and promote social stability. In addition, pension insurance serves as an important channel for personal retirement savings, providing economic security for individuals' retirement life. By paying for pension insurance, individuals can enjoy a stable pension in old age, ensuring a basic standard of living. Pension insurance can also provide corresponding medical and nursing services, allowing individuals to have better health protection in old age. However, the sustainability risk of China's pension accounts continues to escalate as the degree of aging in China deepens. Actuarial data from the Chinese Academy of Social Sciences' World Social Security Research Center indicate that China's basic pension fund surplus will peak in 2027 and deplete by 2035. Presently, China's pension system heavily relies on the first pillar, whereas developed nations like the United States utilize the second and third pillars as major revenue sources for pensions. This diversification lightens the burden on the basic pension and effectively addresses aging populations, achieving balanced pension growth. Currently, China's third pillar pension is still in its infancy, indicating significant growth potential and future support for increasing aging populations. It is imperative to actively learn from the policy experiences of developed countries to gradually improve China's multi-tiered pension insurance system.

1. The Development of the Third Pillar of Pension Systems is a Crucial Strategy for Addressing the Challenges Presented by an Aging Population

In Western Europe and North America, developed nations actively expand their third-pillar pension schemes to mitigate the impact of demographic shifts. According to data from the Organization for Economic Co-operation and Development (OECD), in 32 countries that disclose relevant information, 20 countries have over 50% of their pension systems represented by the third pillar. As of 2019, the third pillar of the United States' pension system reached a staggering $13.83 trillion, accounting for 64.53% of its GDP. Similarly, Denmark (63.04%) and Canada (57.70%) maintain significant proportions. The U.S. third pillar covers more than 34 million people, and countries like the United States and Canada boast coverage rates exceeding 20%. When compared to China, Western nations exhibit substantial advantages in terms of both the scale and coverage rate of their pension systems, driven by more comprehensive incentivization policies for enrollment. Furthermore, these nations have well-established systems for maintaining and appreciating fund value, as well as robust operational regulatory frameworks. These aspects provide valuable lessons for China to consider and potentially adopt.

Table: Three-pillar Pension Policies in Developed Countries in Europe and the United States

Country	The first pillar	The second pillar	The third pillar
United States	Federal Old Age, Survivors and Disabled Insurance Trust Investment Fund (OASDI), consisting of the Old-Age Survivors Trust Fund, Disability Insurance Trust Fund	Government-established public sector pension plans, corporate-established private pension plans, which are presented with 401(k) plans	Individual Retirement Account Plans (IRAs), Life Insurance Company Annuities
Holland	Algemene Ouderdomswet (AOW)	Industry pensions, corporate pensions, specific occupational pensions	Life Insurance Annuities, Bank Annuities
United Kingdom	Basic State Pension Plan, Supplemental State Pension Plan, New State Pension	Mandatory Occupational Pension Plans	Supplemental Commercial Pension Insurance
Norway	Compulsory Universal Insurance Scheme	Mandatory Occupational Pension Plans	Individual Voluntary Commercial Pension Insurance Plans
Australia	Basic Pension, Australia's Future Fund	Superannuation with mandatory employer contributions	Voluntary Superannuation
South Korea	National Pension (NPS), Special Occupational Pension, Basic Old-Age Pension Scheme (BOAPS)	Retirement allowance systems, corporate annuities, individual retirement pension plans	Individual Pension Plans
Japan	National Basic Pension (NBP), National Pension System (NPS)	Employee Pension, Mutual Pension	National Pension Fund, Individual Defined Contribution Annuity

Data source: Compiled from publicly available information on the social security sector in each country.

1.1. Policy incentives for pension enrollment cover several key areas

Firstly, there is significant tax relief. Western countries utilize two complementary models—Exempt-Exempt-Tax (EET) and Taxed at Enrollment (TEE)—to benefit different income groups. For example, the UK's Personal Pension Plan (PPP) and Canada's Registered Retirement Savings Plan (RRSP) both use the deferred taxation model, which benefits middle- to high-income groups by encouraging early pension planning with reduced taxation during the pension withdrawal phase. In contrast, the United States' Roth IRA model employs a contribution taxation plan (Aragie E, 2022), where individuals contribute post-tax amounts to personal accounts and enjoy tax-free status during both investment and withdrawal stages, thus incentivizing lower-income groups who fall below the income tax threshold to contribute towards pensions. Secondly, the variety of pension types is extensive. In the U.S., the third-pillar pension system includes traditional tax-deferred Individual Retirement Accounts (IRAs) and has expanded to incorporate employer-initiated IRAs and Roth IRAs too, thus broadening the beneficiary base and increasing coverage. Thirdly, the entry criteria for pension enrollment are relatively low. The UK's Personal Pension Plan is designed for flexible workers and those without specific employment, thus securing the pension rights of individuals who may not participate in statutory or occupational pension schemes. Similarly, Japan's personal savings account NISA introduced the Junior NISA plan, benefiting individuals aged 19 and below, thereby encouraging a broader age group to join pension schemes. Lastly, there is integration with other funding sources. In the U.S., IRA accounts have absorbed considerable funds from 401(k) accounts. Employees can transfer funds from employer-sponsored retirement plans like 401(k) to IRA accounts upon job change or retirement without losing tax advantages, thereby streamlining the connection among the three pillars and fostering contributions to the third-pillar pensions.

1.2. Policy for Value Preservation and Appreciation.

First, the diversification of investment portfolios is integral. In nations such as Germany, the United States, and Australia, the third-pillar pension funds utilize a variety of investment choices. These include stocks, bonds, mutual funds, and trusts. This diversity effectively mitigates the investment risks associated with pension funds. Second, there is an increased allocation to equity and fund assets. In countries like the United States, Canada, and Japan, third-pillar pensions prioritize mutual funds, trusts, and collective investment vehicles. These asset allocations exceed 30%. Specifically, the allocation towards equity assets in the United States, Australia, and the Netherlands are notably high, reaching 50%, 49%, and 33% respectively. These allocations extend into infrastructure, hedge funds, and real estate investments, generating nominal returns surpassing 5%. Third, the establishment of environmental, social, and governance (ESG) investment frameworks has played a crucial role. Western countries drive environmental initiatives through ESG investment principles. The United States has instituted environmental protection assessment systems to exclude non-compliant assets from pension investments. The Canada Pension Plan Investment Board (CPPIB) actively promotes and practices low-carbon and other ESG ideals. Meanwhile, the Dutch public pension system uses assessments of the negative environmental impacts of investee companies to decide on their investment participation.

1.3. Policy on Operational Supervision

The first is to establish a pension information disclosure system. This allows the insured public to promptly understand the operational status of pensions. For instance, Japan regularly discloses the performance of its third-pillar pensions. Similarly, the United Kingdom's tax authorities periodically collect and reveal tax information related to third-pillar pensions. The second is to implement a regulatory penalty mechanism. The German Federal Financial Supervisory Authority has developed a system for penalizing non-compliant operations within the third-pillar pension sector. This includes revoking industry operating licenses, imposing administrative fines, and initiating legal actions against violators. The third is to create a routine review and evaluation mechanism (Jun-Sheng Z & Duo-Zhen Y, 2018). Regulatory bodies, such as the United States Department of the Treasury, conduct regular compliance reviews of the Roth IRA plan. In Australia, regulatory agencies perform ongoing supervision and management of the financial risks, operational risks, and other aspects related to third-pillar pensions. The fourth is to engage in corporate governance to mitigate investment risks. As significant public capital, third-pillar pensions in countries like the United States and Australia actively participate in the governance of invested enterprises. This participation occurs through occupying board seats, voting at shareholders' meetings, and litigating when necessary, thereby effectively safeguarding the investment interests of the pensions.

2. The Insights of the Third Pillar Pensions Policies in Developed Countries like Europe and the United States for China

2.1. We should diversify participation options and expand the eligible demographic

By integrating the principles of Exempt-Exempt-Tax (EET) and Taxed at Enrollment (TEE), we can progressively broaden the range of pension products available. This approach should include the introduction of targeted tax deferral incentives specifically aimed at middle and low-income groups to lower the entry barriers to third-pillar pension plans, thereby enhancing individual participation enthusiasm. Transitioning from the current product-based model to an account-based model will consolidate the fragmented funds, products, and information services under the product-based system. In the account-based system, individuals can freely subscribe to, redeem, and switch products while managing withdrawals, achieving an organic unification of fund and information flows.

2.2. The enhancement of the market entry environment aims to preserve and augment value

This includes improving the operational framework of pension funds within the capital market (Calvo E, Williamson J B ., 2008), actively promoting the entry of pension funds, and expanding the proportion and scope of various mid-to-long-term pension funds in the market. It involves fostering an industry-wide mid-to-long-term investment philosophy to elevate the share of pension funds in the capital market to the global average level (Erican A T & Kayhan F, 2022). Additionally, there are efforts to establish a third-pillar pension investment in large publicly offered funds, thereby bolstering the investment management capabilities for pensions. Exploration of the docking model for the three-pillar pension accounts aims to integrate the independent status of China's third-pillar accounts, thus activating pension assets and moderately expanding the permissible scope of pension investments. Pension ESG investment channels will be expanded, with clear rules for ESG information disclosure, guided by China's carbon peak and carbon neutrality goals to develop targeted ESG investment products.

2.3. Regulating industry development and ensuring fund security is also paramount

Combining unified and specialized supervision principles guarantees the security of pension funds(Sin Y, 2005). A unified supervisory body and information platform for third-pillar pensions will be established, capitalizing on the expertise of specialized supervisory departments. Various financial regulatory authorities will implement stringent specialized supervision based on financial product classifications. Clearly defining the financial product forms of third-pillar pensions, and standardizing various links such as product entry, design management, sales management, and fund utilization of insurance-based products, are essential. Detailed management systems will be set up for pension target funds, encompassing product types, investment strategies, and fund managers to ensure refined management.

References

[1] Aragie E .Adopting Private Pension System in Ethiopia[J]. 2022.
[2] Calvo E, Williamson J B .Old-age pension reform and modernization pathways: Lessons for China from Latin America[J].Mpra Paper, 2008, 22(1):74-87.
[3] Erican A T, Kayhan F .Voluntary Private Pension Funds and Capital Market Development in Turkey[J]. SSRN Electronic Journal, 2022.
[4] Jun-Sheng Z, Duo-Zhen Y .The Measures and Implications of Private Pension Development in OECD Countries[J].Economic Review, 2018.
[5] Sin Y .China - pension liabilities and reform options for old age insurance[J]. 2005.