Ten Years of the Riester Pension Scheme: No Reason to Celebrate

by Kornelia Hagen and Axel Kleinlein

Since their introduction, the Riester pension scheme and the individual Riester products have become less beneficial to savers. Contracts concluded today will often lead to lower returns compared to contracts concluded in 2001. From a social perspective, meaning pension benefits in relation to individual saving contributions plus state subsidy, overall returns on all insurance-based products are very low. This is due to the general decline in returns on the capital market and, in particular, to a series of government-mandated certification and calculation rules. Urgently needed structural reforms include the abolition of exchange costs, standardized cost information, certification with regards to content instead of formal certification and the regulation of calculation methods. In addition, limiting the number of products is also recommended.

Given the shortcomings of the Riester system, there is good reason to fundamentally rethink old-age pension provision policy. In doing so, a targeted reduction or even elimination of extra public funding ought not to be taboo. The tax saved could be used to strengthen the pay-as-you-go state pension scheme.

In 2001, the pension system was fundamentally reformed.[1] This was associated with a paradigm shift that led to a major social experiment: the »partial privatization« of the pension system. Legislation encourages individual pension plans if capital stocks are established as a certified Riester pension product during the employment phase. In order to receive the subsidy, both savers and providers of Riester products must meet a series of conditions. Savers must currently deposit four percent of their annual gross income liable for contributions into a capital stock to obtain the full subsidy.[2] Savings contributions and state supplements are not funneled into a state-managed »public pension fund« but rather into individual and formally certified pension products. These products are offered by private financial institutions, such as banks, investment companies, and insurance companies which are regulated by the Federal Financial Supervisory Authority.[3]

Nearly 15 million people signed a Riester contract (Table 1) between the introduction of the Riester pension to mid-2011.[4] Ten years after the introduction of government subsidized Riester products, this still represents only about 40 percent of estimated potential Riester sa-

1 See German Federal Parliament (Deutscher Bundestag): Retirement Savings Act (Altersvermögensgesetz – AVmG)). Berlin, Federal Law Gazette (BGBl) Part I, no. 31, (2001): 1310-1343.

2 At the same time, an individual's claim from the general state pension is then reduced by this percentage. Findings on the state and development of subsidies for Riester pensions are regularly published by the Centre for Retirement Savings (Zulagenstelle für Altersvermögen), see Stolz, U., and C. Rieckhoff, „Beitragsjahr 2007: Zulagenförderung nochmals um mehr als ein Viertel gestiegen," RVaktuell, no. 11, (2010): 355-362.

3 Concerning the certification of pension plans and annuity contracts, certification criteria and providers are contained in the Pensions Certification Act (Alterszertifizierungsgesetz, AltZertG).

4 See various press releases from the BMAS, for example, „Boom bei Riester-Rente ist gutes Signal," February 5, 2010, and, more recently, „Fast 15 Millionen Riester Vertragsabschlüsse," August 25, 2011. www.bmas.de/DE/Service/Presse/Pressemitteilungen/riester-rente-zweites-quartal-2011.html.

Table 1

Number of Riester Contracts
Net Year-End Portfolios

	Insurance-like contracts	Riester contracts[1] total	Annual change in percent	For information:	
				Outgoings from insurance contracts[2]	Outgoings from insurance contracts in percent
2001	1 400 000	1 400 000	–	–	–
2002	3 047 000	3 370 500	140.8	85 000	2.7
2003	3 486 000	3 924 440	16.4	99 000	2.7
2004	3 660 500	4 189 500	6.8	180 000	4.7
2005	4 796 900	5 630 900	34.4	145 000	2.9
2006	6 468 000	8 050 000	43.0	179 000	2.7
2007	8 355 000	10 757 000	33.6	259 000	3.1
2008	9 185 000	12 147 000	12.9	480 000	5.0
2009	9 794 000	13 253 000	9.1	–	–
2010	10 380 000	14 397 000	8.6	–	–
For information:					
30.06.2011	10 555 000	14 798 000	–	–	–

1 Insurance contracts, bank savings contracts, fund contracts, Homeowner Riester, two/three-pot hybrid funds, "variable annuities," "unit-linked with profits."
2 Annual reports from top national associations of the insurance industry to the Federal Ministry of Labor and Social Affairs (Bundesministerium für Arbeit und Soziales, BMAS).
Source: BMAS, calculations by DIW Berlin.

Almost 15 million people have concluded a Riester contract—that is just 40 percent of the estimated potential.

vers.[5] Corresponding forecasts that more people would take advantage of the supplements did not come to fruition.[6]

Riester products have been heavily criticized since their introduction ten years ago. Among other things, there has been criticism regarding the lack of transparency and comprehensibility of the offers, high and uncertain costs, a lack of product choice, and inadequate subsidy targeting and windfall gains of high-income earners.[7]

5 The number of possible Riester savers is estimated at 37.5 to 42 million people, see Fassbauer, S., and N. Toutaouvi, „Die Anzahl ders förderberechtigten Personenkreises der Riester-Rente – eine Annäherung," Deutsche Rentenversicherung 64, no. 6 (2009): 478–486.

6 For further details showing that due to the number of contracts concluded, it cannot be considered a success, see Hagen, K., and L.A. Reisch, „Riesterrente: Politik ohne Marktbeobachtung," Wochenbericht des DIW Berlin, no. 8 (2010). Some time ago, DIW Berlin found that, based on data from the Socio-Economic Panel (SOEP), less than ten percent of the younger generation are in favor of a pension plan dominated by self-governing, privately organized pension plans, and over a third of this group of respondents indicated that they believe the responsibility for pensions plans lies with the state, see Schwarze, J., and G.G. Wagner, „Alterssicherung: Gesunkene Zufriedenheit und Skepsis gegenüber privater Vorsorge," Wochenbericht des DIW Berlin, no. 22 (2004).

7 There have been a series of studies looking at and raising critical objections to the different aspects of Riester pensions and related products. From the abundance of literature, there are several recent studies, for example, see Braun, R., and U. Pfeiffer, Riesterrente: Wer nutzt sie und warum? Typisierung der Sparer und Auswirkungen auf die Vermögensbildung, Deutsches Institut für Altersvorsorge, 2011; Geyer, J., and V. Steiner, „Zahl der Riester-Renten steigt sprunghaft: aber Geringverdiener halten sich noch zurück," Wochenbericht des DIW, no. 32 (2009); Lamping, W., and M. Tepe, „Vom Können und Wollen der privaten Altersvorsorge. Eine empirische Analyse zur Inanspruchnahme der Riester-Rente auf Basis des Sozio-oekonomischen Panels," Zeitschrift für Sozialreform 4 (2009): 409–430; Logeay, C., V. Meinhardt, K. Rietzler, and R. Zwiener, „Gesamtwirtschaftliche Folgen des kapitalgedeckten Rentensystems. Zwischen Illusion und Wirklichkeit," IMK Report 43; Oehler, A. with the collaboration of D. Kohlert, Alles Riester? Die Umsetzung der Förderidee in der Praxis. Stärken und Schwächen, Risiken und Chancen der staatlich geförderten kapitalgedeckten privaten Altersvorsorge von abhängig Beschäftigten (ohne Beamte) im Kontext der umlagefinanzierten gesetzlichen Rentenversicherung (2009). Study commissioned by the Consumer Association (Verbraucherzentrale Dachverband); Schröder, C., Riester-Rente: Verbreitung, Mobilisierungseffekte und Renditen, WISO Diskurs, Friedrich-Ebert-Stiftung, 2011.
In addition to scientific studies, the Federal Consumer Association (Vzbv) published a statement about Riester pensions, see. Vzbv, „Vorschläge zur Stärkung der Altersvorsorge im Allgemeinen und der Riester-Förderung im Speziellen," (2011). Position paper by the Federal Consumer Association. In addition, independent product tests are regularly carried out on Riester pensions. Of the numerous test publications, some good examples are provided by Stiftung Warentest: Stiftung Warentest, „Beratung zur Altersvorsorge: Desaströs," no. 5 (2011); Stiftung Warentest, „Etwas Rente ist sicher," „Riester-Rentenversicherungen" (2010): 10, 29–33; Stiftung Warentest, „Spezial Altersvorsorge" (2008): 55–59; Stiftung Warentest, „Rätselstunde für Riester-Sparer," Riester-Jahresmitteilungen. no. 8 (2008): 29–35, and the latest tests by Ökotest. „Jahrbuch. Rente, Geld, Versicherungen. Mehr als 2000 Tarife im Test," Der große ÖKO-TEST Finanzratgeber, (2011): 26–41.

The following identifies problems resulting from the structure of Riester products and changes to certification, as well as regulatory and insurance law provisions implemented between 2001 and 2011.[8]

8 The results presented here are based largely on a study by Kleinlein, A., Zehn Jahre „Riester-Rente" – Bestandsaufnahme und Effizienzanalyse" (2011) conducted on behalf of the Friedrich-Ebert-Stiftung (FES). The study was designed in cooperation with DIW Berlin's Department of Competition and Consumers. The processing of and calculations used in the study are the sole responsibility of the author. The report presented here, in particular its conclusions, are the responsibility of DIW Berlin. Coinciding with the German version of this report, published in the Wochenbericht of the DIW in November 2011, a study by Axel Kleinlein entitled „10 Jahre Riester – Bestandsaufnahme und Effizienzanalyse" was published as part of the WISO Diskurs der FES series.

State Certification Criteria Lead to Shortcomings

The state's legal and structural standards for Riester contracts are governed by the Pensions Certification Act (AltZertG) 2001 (Table 2). Some of the most significant changes to the certification criteria are highlighted below.[9]

9 In addition to the certification provisions discussed here, there are other significant changes that have caused specific problems. One change relates to the fact that savers can withdraw up to 30 percent of the saved capital at the beginning of the pay-out phase. This is accompanied by uncertainty about the amount of the current pension benefits. Another problem relates to securing the longevity of non-insurance-based products. The contractual options for the „pension from 85" are still far from certain. The Federal Ministry of Finance (BMF) recently referred to this problematic situation and suggested that additional information requirements should be introduced at the end of savings period or at the beginning of the pay-out phase.

Table 2

Certification Criteria for Riester Products

	Initial situation in 2001according to the Pensions Certification Act[1]	Changes to certification criteria up to 2011
Contributions in the savings phase	Saving must occur through regular payments	Deleted
Commencement of benefits	Payment earliest from 60th birthday; except for earlier retirement	Civil servants included in funding Introduction of unisex tariff Payout from 62nd birthday
Capital preservation/Nominal value promise	At least the paid-in capital contributions plus allowances must be available at the beginning of the payout phase.	
Pension payments/benefit payments	Payments in the payout phase must remain the same or increase.	Up to 30 percent of the accumulated capital can be paid out at the beginning of the payout phase without affecting allowances. With savings plans, the "pension from 85" can begin before the 85th birthday.
"Annuity"/"pension from 85"	With non-insurance-like contracts, the payout phase must occur until the death of the insured.	Certification criteria moved to "pension payment"
Provision for surviving dependents	must be possible	Certification criteria moved to "start of benefits."
Eligible products	Private pension funds, bank savings plans, fund savings plans	Introduction of "Homeowner Riester" Deletion of product catalogue
Distribution of acquisition and distribution costs	With insurance-like products: allocation of acquisition and distribution costs over at least ten years Non-insurance-like products: advance charging of costs distributed over ten years	Allocation of acquisition and distribution costs over a minimum of five years
Annual disclosure requirements during the term of the contract	Information on use of contributions, the amount of saved capital, retained acquisition and distribution costs, administrative costs, earned income, ethical, social, and ecological orientation of the capital investment Withdrawal of certification and levying of fine possible.	Review of information requirements is no longer a criterion for certification. Breach of notification requirements may only be penalized by fines of up to €2,500. In case of a complaint by the saver, the certification authority does not have to get involved.
Suspension, change of provider/product, termination in the savings phase	Payout of capital must be possible for a self-occupied property.	
Assignment/pledge to third party	Not possible	Deleted

1 Riester products are certified according to the Pensions Certification Act (AltZertG), the certification criteria contained in paragraph 1 of the AltzertG. Paragraphs 2-6 pertain to the act of certification by the certification authority, paragraph 7 of the AltZertG deals with the information providers are required to give to customers, are paragraphs 8 to 14 concern other regulations, such as fees for certification.

Sources: Hagen, Reisch 2010, FES 2011, and DIW Berlin.

The Pensions Certification Act sets the legal stipulations for certifying Riester products.

Introduction of Unisex Tariff Leads to Insurance Company Surpluses

The Riester pension was initially conceived with gender-based tariffs. From a socio-political standpoint, this was highly undesirable. Riester contracts concluded after 2005 may no longer differentiate by gender when calculating pension benefits.[10] The aim of this regulation was to produce a gender-neutral calculation. The statutory provisions for calculating gender-independent tariffs were implemented by the insurance companies in such a way that, in addition to the »normal« longevity risk, they also incorporated a »the insured is a woman« criterion as a longevity risk. This resulted in a greater longevity risk compared to earlier calculations. Consequently, overall premium levels are considerably higher than "average" premiums for men and women.

As a result, the implementation of the unisex tariff led to a significant increase in the premiums required for men to achieve a "target pension", while the premiums for women were only reduced slightly, or the old tariff was retained. For insurance companies, the higher premiums lead to additional mortality gains arising from the increased probability of men dying sooner than shown by the calculations in the new unisex table. In addition, a new regulation on »profit participation« results in a greater share of these additional mortality gains going to the insurers.[11]

Capital Preservation Only at Beginning of Payout Phase Restricts Provider and Product Changes

Another certification criterion for Riester products is capital preservation at the beginning of the payout phase according to the Pensions Certification Act. Since the value of fund savings plans or unit-linked pensions may drop temporarily, this regulation all but nullifies the principle of exchange law for individual savers because any exchange would make no economic sense since it results in a reduction of capital value below the value of the saved capital. But even for savers with guaranteed products, which have a guaranteed value during the savings period, there is only a limited opportunity for switching to a different contractor, due to capital preservation fixed to a certain date. Because as a rule, the new provider will again charge acquisition costs. This basic problem for savers with already high savings premiums is further exacerbated by the fact that the acquisition costs when switching are often charged at a fixed percentage rate of four percent of the capital to be transferred. Thus, the cost of switching a contract increases, the higher the payments on the Riester contract already are.[12]

By specifying capital preservation, the legislation has actually restricted an important market mechanism because a functioning exchange law normally prevents poor quality providers from remaining in the marketplace, for example, those supplying inadequate information or selling expensive products.

Contractual Disclosure Requirements: Total Expense Ratio May Give False Picture of Cost Burden

Some scientific studies, consumer organizations, and independent product tests have confirmed that Riester products are not sufficiently transparent.[13] The focus of criticism here is on legal disclosure obligations contai-

10 The unisex tariff for all types of insurance is mandatory; this applies to all eligible pension schemes and, therefore, also to the Riester pension. This regulation is based on Directive 2004/113/EC of the Council of the European Union dated December 13, 2004 on implementing the principle of equal treatment of men and women in accessing and supplying goods and services. This Directive was incorporated into German law through the General Act on Equal Treatment (Allgemeine Gleichbehandlungsgesetz, AGG), as Article 1 of the Act to implement European Directives relating to the principle of equal treatment (Implementation Act) dated August 14, 2006, Federal Law Gazette (Bundesgesetzblatt) I, 1897.

11 From an actuarial perspective, the gender criterion for calculating insurance and supply contracts is an objective and risk-specific differentiating factor. From the perspective of actuaries, the application of gender-independent factors means a lack of accuracy in calculating insurance and supply contracts, and these changes will lead to there being winners and losers, and it will be more expensive overall. See German Actuarial Association (Deutsche Aktuarvereinigung), „Unisex-Tarife: Konsequenzen des EUGH-Urteils aus aktuarieller Sicht," press release dated April 28, 2011. https://aktuar.de/php/evewa2.php?d=1321091955&menu=01060130.

12 In contrast to the acquisition costs charged by new providers, many providers of pension insurance or bank savings products only charge between 100 and 150 euros to cancel existing contracts.
The legislature has also limited the distribution of costs for insurance-like products to at least five years. When the Riester pension was introduced, it was still ten years. Since these costs reduce the net investment sum, it now takes longer for the contract value to correspond to the amount of capital paid in. This also restricts changing providers. On this issue, see „Die Lücke schließen," Finanztest, no. 10 (2002): 72–87. In the case of fund offers, the initially permissible advance charging of costs, in which all acquisition costs could be charged right at the beginning of the contract for all contractually agreed savings contributions, was prohibited. However, as a result of case law, the advanced charging of costs may still be spread over five years. It is remarkable to note that non-supplemented fund contracts have a higher level of consumer protection in this regard than the supplemented Riester fund savings plans. But investors are not obliged to inform their clients about it.

13 Finanztest and Ökotest have conducted various Riester product tests, see „Etwas Rente ist sicher," Finanztest no. 10 (2010): 29-33; and Ökotest „Reise ins Labyrinth," no. 6 (2011): 76-81. Various scientific studies have also dealt with this topic, see, for example, Center for European Economic Research (ZEW) in cooperation with IFF Hamburg and Infas, "Transparenz von privaten Riester- und Basisrentenprodukten. Abschlussbericht (2011)". This report was commissioned by the Federal Ministry of Finance. The results from another report commissioned by the same ministry on the development of transparency measures for Riester products are still awaited.

ned in the Pensions Certification Act, and in particular, the reporting of costs.[14] The compliance with disclosure and cost transparency regulations was a mandatory and fail-safe criterion criteria when the Riester pension was introduced. A violation may have led to the certificate being withdrawn or a fine being levied. But both were removed from the list of certification criteria. Today, a violation of information and transparency obligations would only have minor consequences for the contract provider. A fine may be levied as a result of consumer complaints, of which there are plenty. There have, however, been no penalties issued by the certification authority to date.[15]

There have been discussions for some time now on the introduction of standardized, mandatory information to improve the cost transparency of Riester products.[16] The German Insurance Association (Gesamtverband der Versicherungswirtschaft, GDV) and Allianz Lebensversicherung, among others, have been suggesting a cost indicator, the "total expense ratio."[17] It should be noted, however, that the information content of this indicator can be misleading.[18] This is because the amount of losses of returns (total cost ratio) is calculated prior to the agreed term of the savings agreement. But if a contract offers variations in terms of the start of the pension and savers take up this option, there will be a difference in the calculated and the actual start of the pension. This leads to an underestimation of the cost burden. As a result, savers may take an economic decision to their own detriment despite being fully informed by the provider.

It is obvious that rationally choosing a Riester pension requires a consumer to be very well-informed with above-average knowledge and able to rationally choose a pension product based solely on economic efficiency. However, it is known from behavioral and information economics that savers are not fully informed. They often make decisions not based on rational considerations. Learning from disclosure obligations would require at least simple information architecture.[19] However, to date, policymakers have not managed to move beyond the discussion stage on possible transparency measures.

Certification-Independent Calculation Bases and Profit Participation

In addition to certification criteria, yields from Riester products are characterized by product calculations and profit participation. The bases of calculation are the guaranteed interest rate, assumed mortality, and the costs. Calculation factors and profit participation are based in particular on regulatory and insurance law provisions (Table 3). Providers do have a certain amount of scope in calculating Riester products with regard to what assumptions they want to make about mortality rates and what version of the mortality table they want to use to calculate their insurance premiums. Each company calculates the costs individually.

Guaranteed Interest Has Dropped by Almost a Third

The guaranteed interest rate depends on developments in the financial markets.[20] When the Riester pension was introduced, the guaranteed interest rate was 3.25 percent. It has dropped to 2.25 percent since and will fall again at the beginning of 2012. New contracts will only assure a guaranteed interest rate of 1.75 percent.[21]

14 Transparency should also come from product tests. Moreover, in recent years, in addition to certification regulations, a pre-contractual, non-standardized product sheet and consultation records have been introduced for financial products in general.

15 For complaints about Riester products, see Hagen, K., and L. Reisch, „Riesterrente: Politik ohne Marktbeobachtung."

16 See BMF, „Transparenz von privaten Riester- und Basisrentenprodukten," Monatsbericht digital, September 2010. www.bundesfinanzministerium.de/nn_17844/DE/BMF__Startseite/Publikationen/Monatsbericht__des__BMF/2010/09/analysen-und-berichte/b03/node.html?__nnn=true

17 See GDV total expense ratio, for example, GDV, „GDV empfiehlt umfassende „Preis-Leistungs-Darstellung" in der Lebensversicherung," GDV press release dated January 19, 2011. www.gdv.de/Presse/Pressemeldungen_2011_Uebersichtsseite/inhaltsseite28180.html. The total expense ratio specifies the average reduction in yield per annum that savers can expect during the savings period, assuming a fixed interest rate before costs, (reduction in yield). Therefore, in principle, it is a „reduction in yield." Another cost indicator is the cost ratio, which indicates the reduction in performance due to scheduled costs.

18 See Kleinlein, A., „Die Kostenquote der Versicherer kann Verbraucher in die Irre führen," Versicherungswirtschaft 7 (2011): 457.

19 Since financial and Riester products are credence and contract goods, the quality of such goods cannot be determined at all or only to a very limited extent. In addition, savers display systematic anomalies as economic behavioral experiments show. See Hagen, K., and L.A. Reisch, „Riesterrente: Politik ohne Marktbeobachtung."

20 The basis for this is the actuarial reserve stipulation (Deckungsrückstellungsverordnung, DeckRV) which in turn is based on the Insurance Supervision Act (Versicherungsaufsichtsgesetz, VAG). In addition to setting a maximum interest rate, it also stipulates that the zillmerization rate related to total premiums may not exceed four percent and that the calculation must be cautious.

21 This is why insurers were encouraging savers to conclude a life insurance policy before the end of 2011. However, the German Association of the Insured (Bund der Versicherten, BdV) is warning consumers to make their decision to conclude a contract dependent on the guaranteed interest rate. A number of providers are already promising less than the guaranteed interest on the savings portion, see BdV press release, „BdV warnt vor übereilten Abschlüssen" dated October 31, 2011. www.bundderversicherten.de/news/705/BdV-warnt-vor-uebereiltem-Abschluss

Table 3

Basis of Calculations and Riester Profit Distribution

Broad parameters	Starting position in 2001	Changes up to 2011
Guaranteed (maximum) interest on pension-type products	3.25 percent according to the Actuarial Reserve Stipulation	2.25 percent (from January 1, 2007) 1.75 percent (from January 1, 2012)
Mortality table	German Association of Actuaries, DAV94R	From January 1, 2005: DAV04R with higher life expectancies and unisex mortality table
Costs	No standard guidelines, company-specific costs	
Profit shares for savers	At least 90 percent	Interest earnings: at least 90 percent Mortality/risk profits: at least 75 percent Costs gains: at least 50 percent

Sources: FES 2011, DIW Berlin 2011.

Since its introduction, the calculation regulations for Riester products have changed to the disadvantage of savers.

Life Insurers Calculate with Very High Life Expectancy

Insurers use mortality tables to calculate what is known as the longevity risk. These tables are used to estimate the number of deaths in a fictitious collective in a contract year.[22] The number of survivors per contract year and the resulting pension benefits are calculated on the basis of the mortality table.

There are various mortality tables, such as multiple variants from the German Actuarial Society (Deutsche Aktuarvereinigung, DAV), the Federal Statistical Office (Statistisches Bundesamt), and mortality tables specific to companies. The tables differ in figures on life expectancies and they consider different specific risks. The individual insurers are not obligated to use any particular mortality table for their calculations. The relevant supervisory authority, BaFin, only recommends that insurers use a mortality table which, in the view of the supervisory authority, represents an appropriate calculation basis. It is not transparent for the insured as to which mortality table is used for the product calculation.

Until 2004, the supervisory authority recommended the mortality table compiled by DAV, DAV94R, which differentiated according to gender. Currently, a new standard work, DAV04R, that takes a unisex mortality table into account is being recommended.

All DAV works share that they overstate the longevity risk to safeguard their calculations. They all calculate their products with a particularly low mortality rate and very high life expectancy.[23] In addition, individuals who have had pensions in the past (with particularly high contract volumes) and had a longer life expectancy than people without pensions (selection effects) and who are above average in terms of socio-economic criteria, are weighted more favorably.[24] Also, the life expectancy of people with very high contract volumes is weighted more heavily than the life expectancy of other people.

In the Federal Statistical Office's mortality table, no special risks are taken into account, but instead it merely considers the »pure« mortality rate by year of birth and gender (generation mortality tables).[25] The mortality rate is therefore much lower and life expectancy is much higher than in the DAV works.

An example of life expectancy using the different mortality tables shows that, according to the current mortality table, insurers make pension calculations with a life expectancy of between 3.5 and eleven years higher

22 There are various types of mortality tables. Insurance industry products are often calculated on the basis of period mortality tables. These tables monitor the mortality of living generations living simultaneously in a manageable period of time. In addition, there are generation mortality tables. Here, mortality rates depend on age, gender, and also the year of birth. This allows the increased life expectancy of people born later to be taken into account. Pensions are calculated according to generation mortality tables. Sometimes insured mortality tables are also used which take into account that the mortality rates of the insured group differ from the mortality rates of the general population as a whole, due to self-selection or health checks.

23 The life expectancy depends on the age of the insured: the older a person, the higher the life expectancy.

24 See „Herleitung der DAV-Sterbetafel 2004 R für Rentenversicherungen," Blätter der DGVFM, vol. XXVII, no. 2, October 2005 by the DAV's sub-working group on pension mortality (DAV Unterarbeitsgruppe Rentensterblichkeit), 263 f. Appendix 3 „Abhängigkeit der Sterblichkeit von der Höhe der versicherten Rente"; Himmelreicher, „Die fernere Lebenserwartung von Rentnern und Pensionären im Vergleich," WSI Mitteilungen 5 (2008): 274 ff.

25 See Federal Statistical Office (2006): „Generationensterbetafeln für Deutschland. Modellrechnungen für die Geburtsjahrgänge 1871–2004." This table is a generation mortality table, as opposed to period mortality tables.

than the Federal Statistical Office, depending on gender, age, and the year in which the contract was concluded. As a result, it is significantly more expensive to purchase annuity than it would be if the Federal Statistical Office's mortality table were applied.

A comparison of life expectancies in the different mortality tables for a female aged 35 who concluded a Riester contract in 2001 (2011) clearly shows the consequences of using this mortality table as a basis of calculation (Table 4). According to the Federal Statistical Office's mortality table, the model female saver would have a life expectancy of 87.04 (88.21) years. If the contract concluded with conditions of 2001 (2011) were calculated on the basis of the currently recommended mortality table, the premium for the Riester contract would be calculated with an increased life expectancy of almost five (9.5) years. In principle, a higher life expectancy makes the contract premiums more expensive.

Table 4

Life Expectancies According to Various Mortality Tables

In years

	StatBA	MathConcepts 2011[1]	DAV standard calculation table (DAV04R)
Contract beginning in 2001 at the age of 35 years			
Women	87.04	88.68	91.93
Men	81.50	82.47	85.12
Contract beginning in 2011 at the age of 35 years			
Women	88.21	89.87	97.65
Men	82.75	83.73	93.49

1 The mortality table from MathConcepts considers elements of both the DAV and StatBA tables.

Sources: Federal Statistical Office 2006, MathConcepts, German Actuarial Association, FES 2011, calculations by DIW Berlin..

Men and women live longer according to life insurers than according to the Federal Statistical Office.

Profit Participation Has Been Changed in Favor of Insurers

As a result of the careful calculation methods, for example the high life expectancy, life insurers will normally generate excess profits from both classic life insurances and insurance-like pension contracts.[26] Generally, there are three different sources. Net interest income is generated by the insurer getting a higher interest rate on the customers' capital than the guaranteed interest rate. Cost surpluses are achieved if the insurer actually has to spend less than the calculated cost schedule. Risk and mortality profits occur when the insured person dies earlier than assumed in the calculation.

When the Riester pensions were first introduced, supervisory regulations stipulated that 90 percent of all profits and surpluses had to be distributed to policy holders.[27] Since 2005, however, savers' participation in 90 percent of profits only applies to net interest income, which has decreased in importance due to recent economic developments in the financial market.[28] In regard to cost surpluses, which have always played a rather minor role, providers may no longer withhold just ten percent, but a maximum of 50 percent. As a result, revenue opportunities for insurers from these profits have increased five-fold due to this single legal regulation.

For mortality risk and profits, whose percentage of total profits has been increasing for years now, savers are only legally guaranteed a minimum participation of just 75 percent. The share of these profits that the insurer may keep thereby increases from ten to 25 percent. The distribution changes also retrospectively affect contracts concluded before the redistribution (2002-2004). There is a tendency to calculating as follows: the higher the calculated life expectancy, the higher the mortality profits. Younger policy holders benefit most in terms of the percentages of profits paid out to the savers.[29]

26 Profit participation affects virtually all supplemented contracts, since almost all Riester contracts, with the exception of the Homeowner Riester, must flow into a private pension by the time the saver is 85 years old at the latest. Guaranteed pensions at the beginning of retirement will be increased through profit participation up to the beginning of retirement. Profits allocated to the contract during the pension term increase the pension as of the next pension reference year.
Comparative analyses of the course of the pension with and without mortality profits were implemented for different pension offers in product testing, see the many product tests by Ökotest, for example, Ökotest, „Rieser-Rente-Reinfall statt Rendite," (2010).

27 But it is at the sole discretion of the various providers as to when funds from these profits are actually credited to the individual pension contracts. In practice and in general, profits are first placed in a reserve for premium refunds (Rückstellung für Beitragsgewähr, RfB). In addition, there is scope for the insurers to allocate high or low profits to certain contracts.

28 This new distribution of profits is regulated in the Minimum Funding Regulation (Mindestzuführungsverordnung, MindZV), in force since 2008, concerning minimum premium refunds for life insurance policies.

29 It should also be noted that the altered mortality table has already been accompanied by higher premiums compared to the years prior to 2005, but that mortality rate profits are not distributed until decades later. It is also relevant to note that for contracts concluded up until 2004, the rate hikes from the introduction of the unisex tariff valid until 2025 are part of the profits not available to policy holders for pension benefits because these profits are used to finance the unisex tariff for the old contracts.

Box 1

Yield Indicator: "Age for a Target Yield"

This indicator calculates how old a saver needs to be to achieve a certain target yield. Here, the internal interest on cash flow from funds paid into the Riester contract and funds paid out to savers as a pension constitute the yield. This indicator is intuitive for savers. The target age for a desired yield of zero is based on the age savers need to reach to recuperate at least the money they pay in, plus subsidies without interest. It is calculated as the sum of total contributions paid in and allowances, divided by the guaranteed monthly pension amount. Since individual contributions and allowances are added, this calculation reflects the social perspective of the Riester pension.

The target age can also to be calculated for additional yields. Here, the precise age at which the internal interest rate on cash flow generates the desired yield is calculated according to the paying in period of the savings phase, the amounts paid in, and the payout dates. If inflation is also taken into account, the target age is exactly the age savers need to reach in order for them not to make any losses due to inflation.

Worthwhile Riester Yields Only Possible for Policy Holders who Live up to an Old Age

Taking into account the certification criteria, the calculation parameters, and the profit participation, a yield indicator was calculated for several »model Riester persons« (Box 1).[30] The following example considers a Riester saver aged 35 years who concluded a pension contract in 2001 (variant with no adjustment for inflation). If a woman (man) in this model group wants to receive a yield of zero, that is, receive only her (his) Riester contributions plus the subsidies received as an annuity, then she/he has to live 78.4 (76.8) years, an age that women (men) can quite realistically reach. If profits are also added to the contract, the target age to be attained is reduced by a further three years (Table 5).

However, the woman must reach 90 years of age if she wants to achieve a target return of 2.5 percent. She would have to live to be an impossible 128 years old in order to get a return of 5 percent interest on her saved capital in this otherwise equal variant. If such female savers also received a profit on their Riester savings, the target age would be reduced yet again. In order to achieve an interest rate of 2.5 or five percent in this case, the woman (man) would now have to live to 82 or 92 (79.7/87.1) years of age.[31] If an adjustment for inflation is also taken into account for the model person, the target age increases slightly in almost every variation.

The choice of mortality table and the differences in life expectancy have a very significant and stronger effect on yields from the Riester contract than a reduction in the guaranteed interest rate, and this is irrespective of whether the guaranteed yield or the guaranteed annuity takes surpluses into account. Profitability in both cases deteriorated after applying the DAV04R mortality table. The choice of mortality table for women has a similar effect to lowering the guaranteed interest rate. But with men, the use of mortality tables increases the age required to achieve a particular yield, not only in the case of a guaranteed annuity, but also taking into account profit participation. It can be deduced from this that the introduction of the new mortality table has led to a greater reduction in profitability for men than for women.

The introduction of the unisex table compared to a DAV04R gender-specific table has resulted in diminished target yields for women, but has increased them for men.[32] This means that the age needed to achieve a certain yield slightly increases for women, but noticeably increases for men. For example, based on a gender-dependent tariff, a model woman (man) who concludes a contract at the age of 35 would have to become 78.4 (76.8) years old to achieve a zero rate of return. If the unisex tariff introduced later had applied in 2001, the target age for women would have decreased moderately, but for men it would have increased noticeably. The reason for this is that the unisex mortality table is not

30 Other possible yield indicators are the annuity rate, the return on savings at the start of benefits/pension (return on savings), the bond yield (profitability analysis including costs of drawing the pension), and the share of funds for the „pension from 85." Here, the annuity rate determines how much pension savers will receive from an offer if they have saved, for example, 100,000 euros, by the time they retire. The savings rate of return indicates how high the interest rate on a savings account needs to be for the saver to have saved as much as in the original offer by the time they retire. The bond yield shows how much yield can be expected if the pension is paid in for as long as the average life expectancy. The cost effects of drawing the pension are also taken into account. The share of funds for the „pension from 85" determines for Riester contracts with a payout plan up to 85 years of age how much saved capital has to be reserved at the start of retirement for a saver to be able to receive a „pension from 85" against a one-off payment.

31 As a reminder: the life expectancy for this group of women (men) in the DAV mortality table is almost 92 (a good 85), and only 87 (81.5) at the State Statistical Office.

32 It can also be observed that a number of insurance providers do not base their calculations on the unisex tariff, but solely according to the female mortality rate.

Table 5

Riester Yields Indicator for Insurance-Like Products
Required Age at Death in Years

	2001 (gender-dependent tariff)		2011 (unisex tariff)	
	Female saver	Male saver	Saver	Saver
Expected yield	Classic product			New product
Without salary developments				
Guaranteed benefits variant				
0 percent	78.4	76.8	84.2	86.9
2.5 percent	90.0	85.8	109.8	124.5
5 percent	127.9	105.5	not achievable	
Annuity with profit participation variant				
0 percent	75.4	74.3	77.1	78.8
2.5 percent	82.0	79.7	84.8	88.4
5 percent	91.8	87.1	96.2	104.1
With salary developments (adjustment for inflation: 2.5 percent)				
Guaranteed benefits variant				
0 percent	79.2	77.4	85.0	87.9
2.5 percent	90.4	86.2	109.4	123.9
5 percent	124.5	104.3	not achievable	
Annuity with profit participation variant				
0 percent	76.2	74.9	77.9	79.8
2.5 percent	82.7	80.3	85.5	89.3
5 percent	92.0	87.3	96.4	104.4

Model persons: saver: contract concluded at 35 years of age; annual income: 30,000 euros; children: two; marital status: married; total premium: 1,200 euros consistently (without Riester scale); end of contract: at 67 years.
Model assumptions for calculation parameters: average cost burden: 12.5 percent, including acquisition costs amounting to 4 percent; total interest after profit participation: 4.5 percent; inflationary adjustment: 2.5 percent; guaranteed interest rate for 2001 (2011): 3.25 (2.25) percent; distribution of profits in 2001 (2011): 90 (net interest income: 90 percent; risk profits: 75 percent, cost surpluses: 50 percent); mortality table: modified mortality table from MathConcepts.
Source: Kleinlein/FES 2011, calculations by DIW Berlin..

Profitable Riester requires long life.

compiled like an average mortality table for men and women, but is geared towards women. Based on the regulations from 2011, the respective target ages of women and men increase significantly, since overall higher life expectancies have been assumed.

Product tests show that new products are calculated on the basis of mortality tables with maximum life expectancy, and savers are not credited with sums that savers with classic products still receive.[33] Irrespective of new product packages, both tariffs mean that target ages will have to increase significantly in order for certain target yields to be achieved. This is more evident in men than in women. Consequently, calculations for new product offers show that they are only profitable, from a societal point of view, with one profit participation and if the life expectancy of the saver is unattainable, or only attainable in rare cases.

Summary: For average savers, contracts concluded in 2011 generate lower yields and lower pension benefits than those concluded with conditions of 2001. This deterioration can be attributed to government changes in product calculation, to the guaranteed interest rate, and even more so to the mortality table and the unisex tariff used, as well as new product structures. The analysis also shows that the profitability of contracts concluded by 50-year-olds is lower than for contracts concluded by 35-year-old savers.[34]

33 For example, with variable „annuities“ tariffs, in which no risk or cost gains are normally provided for, or restrictions in profit participation with classic tariffs, such as the classic Riester pension from Allianz Lebensversicherung, see Ökotest „Reise ins Labyrinth“ (2011).

34 This basic trend can also be shown with other profitability indicators; Kleinlein, A., „Die Kostenquote.“ In addition, a gender-specific analysis shows that the pension yields of men have decreased compared to women, that almost three times more saved capital is reserved for the „pension from 85“ as with contracts concluded in 2001, and therefore only limited funds are available for payouts up to 85.

Box 2

Basic Considerations for a Funded Pension Scheme

Going beyond the comprehensive regulation of Riester products, the question arises as to whether an additional funded pension scheme is at all useful. Two main arguments were presented in favor of the Riester pension scheme: firstly, the interest will lead to higher pension benefits for individual savers than the pay-as-you-go system, and secondly, a funded pension scheme is less susceptible to demography than the pay-as-you-go system.

However, Riester pensions show how funded pension schemes can be susceptible to short-term financial market developments. With the reduction in guaranteed interest rate, the effective interest rate of four percent originally targeted for Riester products has become very uncertain. It is not possible to calculate a target yield for individual retirement age, and therefore for individuals, from profit participation. It is precisely the underlying uncertainty in any capital cover system that makes them very risky for pensions in the lower income bracket. Funded pension schemes are only useful insofar as the targeted basic protection for old age is fully secured by government pay-as-you-go funding.

The second argument—the alleged greater independence from an ageing society—is not true in this simple form. The increase in life expectancy, resulting in increased premiums for the pay-as-you-go scheme (or reduced pensions), also leads to longer pension durations in the funded pension scheme and, therefore, to lower effective pension payments with the same premiums.

In addition, there are also potential yield problems with an aging society, such as the decline in prices of investment properties in areas where populations are shrinking considerably.

If these arguments are socio-politically weighted, it turns out that a decrease in yield from funded pension products is very risky for policy holders in the lower income bracket. In the upper income bracket, a voluntary mixture of pay-as-you-go and funded pensions is a way to hedge against the problems of a particular form of pension using a mixed portfolio. But since it is not clear if this really works, this is not to be recommended from a socio-political point of view for the lower income bracket so as to prevent low income or poverty in old age.

If legislation on pension policies were to be reconsidered and the conclusion drawn that the funding of new Riester contracts should be abandoned, this would not automatically mean that public funds already expended on the Riester contracts would simply disappear, that is, they would be saved. If the Riester pension were to be abandoned, the money saved could also be targeted into the state pension system thereby creating scope, for example, to protect low-wage earners and lower income groups with a minimum government pension.[1]

1 Meinhardt, V., and M. Grabka, (2009) discuss an example of how the pension system could be restructured: "Grundstruktur eines universellen Alterssicherungssystems mit Mindestrente," Diskussionspapier des Gesprächskreises Sozialpolitik der Friedrich-Ebert-Stiftung.

Conclusions: »Riester« Is Often No Better Than Putting Money in Your Piggy Bank

Ten years ago—when the Riester pension and its products were introduced—an assessment of the opportunities and risks of funded and private pension plans concluded that the problems of a declining population would not be solved simply by changing the financing procedure. (Box 2).[35] In particular, it was believed that the risk of a funded pension scheme lay in the fluctuations of return on investment, that is, the dependency of pensions on the development of the financial market. In particular, funded pension plans were deemed risky, especially for pensions in the lower income bracket. There was concern that the lack of socio-political orientation would be disadvantageous to the Riester system. Risk diversification was seen as a particularly good option for funded pension plans.

It was recommended that the government develop criteria for good pension plans in conjunction with the providers. There were calls for the products to be identified with a seal of quality, for policy changes to be possible in principle, and for the administration to be good and inexpensive. The government is asked to check if federal regulation might be appropriate.[36]

35 See Kirner, E., V. Meinhardt, and, G.G. Wagner, „Probleme der Altersvorsorge allein durch Änderung des Finanzierungsverfahrens nicht zu lösen," Wochenbericht des DIW Berlin, no. 30 (2000).

36 See Leinert, J., and G.G. Wagner, „Riester-Rente kann entscheidend verbessert werden," Frankfurter Allgemeine Zeitung, July 18, 2003.

The general opportunities and threats of funded pension schemes are largely the same today as they were then. However, specific pension products have developed differently than was desired at that time. From a consumer protection perspective, the flaws in Riester products need to be exposed. The structure of Riester products gives the impression of a ragtag mix of state, private, and market. The certification and calculation of the Riester products are, in fact, extensively constructed with a view to protecting the interests of the insurer. For many people, the Riester products are not transparent and from a societal point of view, only generate a worthwhile yield if the saver lives to a ripe old age. But for many Riester savers, the yield is no higher than if they had put their savings in a piggy bank. This is socially and politically unacceptable for consumers because pension schemes are a vital commodity and the »Riester« is a product on which taxpayers' money is spent.

On the positive side, at least the legislation has paved the way for minor measures to create transparency and to improve the accessibility of information. The Federal Ministry of Finance is also currently discussing compiling a positive list of allowable cost components. In addition, a mandatory, standardized, and transparent representation of costs has often been suggested but is not yet a finished instrument. The proposal by consumer advocates to test standardized product information for its comprehensibility to consumers prior to its introduction has not yet been addressed.

It is also a failure of those responsible for the Riester scheme that Riester savers sometimes still incur very high costs if they are dissatisfied with their provider and want to switch. This failure needs to be remedied as soon as possible.

It is somewhat confusing that the government does not specify legally binding calculation methods for state-funded pension products. This pertains to the mortality tables and profit participation, giving rise to the question why the insurer should be given a share in these profits at all.

Given the proven shortcomings of Riester products and in respect to the critical findings of many other experts, also concerning other aspects of the Riester scheme not outlined here, minor measures are simply not sufficient. In light of these findings, a fundamental rethink of Riester products is needed.

There is also a need for restrictions on the number of supplemented products. It might be appropriate to create a positive list with a few recommended, comparatively profitable, low-cost yet safe products. This would require a certification process that evaluates content and classifies products according to risk categories or profiles. An alternative method of certification would be a selection of products through public tender. The Swedish model of government products demonstrates an even better regulation option. For individual citizens, the advantage of a positive list or a government product would be that the pension benefits would come from a single source and the costs would certainly be no higher and the yield no less than for products from private insurers. This would negate the need to choose from a vast range of products. If no such fundamental improvements are made, there is a good argument for abandoning publicly funded, private and capital-based Riester products.

Kornelia Hagen is a Senior Research Associate in the Department of Competition and Consumer | khagen@diw.de

At the time of writing, **Axel Kleinlein** was an independent actuary, on the board of the German Association of the Insured since 1 November 2011 | a.kleinlein@mathconcepts.de

JEL: D18, D82, D91, E21, H55

Keywords: Private pension provision, Riester scheme, funding principle, Welfare State

Article first published as "Zehn Jahre Riester-Rente: kein Grund zum Feiern", in: DIW Wochenbericht Nr. 47/2011

DIW BERLIN

DIW Berlin—Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
T +49 30 897 89 -0
F +49 30 897 89 -200

Volume 2, No 2
3 February, 2012
ISSN 2192-7219