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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the application of Annex XII to the Staff Regulations

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INTERIM REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the application of Annex XII to the Staff Regulations

1. LEGAL BASIS

Pursuant to Article 14(2) of Annex XII to the Staff Regulations (SR), in 2018 the Commission shall submit an interim report to the European Parliament and the Council on the application of Annex XII to the Staff Regulations.

The aim of this interim report is to present an overview of the implementation of the rules for keeping in balance the Pension Scheme for EU Officials (PSEO) in the period 2014-2018. Those rules are laid down in Article 83a of the SR and Annex XII thereto[1].

2. BASIC FEATURES OF PSEO

2.1. Legal basis of PSEO

Pursuant to Article 83 of the Staff Regulations:

- The benefits paid under the pension scheme[2] are to be charged to the Union budget;
- Member States are to jointly guarantee the payment of the benefits; and
- Officials are to contribute one third of the cost of financing the scheme.

Article 83a provides that the balance of the pension scheme shall be ensured by the pensionable age and the rate of contribution to the scheme. It also lays down procedures for annual and five-yearly updates of the rate of contribution to the pension scheme.

Annex XII to the SR sets out the actuarial rules for computing the contribution rate in order to ensure that the scheme is in balance.

2.2. Notional (virtual) fund principle

The PSEO is a notional (virtual) fund with defined benefits, in which staff's contributions serve to finance their future pensions. Although there is no actual investment fund, the amount that would have been collected by such a fund is considered to have been invested in the Member States' long-term bonds and is reflected in the pension liability that is registered in the annual accounts of the European Union. Member States jointly guarantee the payment of the benefits pursuant to Article 83 of the Staff Regulations and Article 4(3) of the Treaty on European Union.

As the PSEO is designed as a notional fund, staff contributions serve to finance the future pensions of those contributing. The contributions actually cover the cost of the pension rights acquired in a given year and are in no way linked to that year's pension expenditure. EU case-

[1] Pursuant to Article 83a of the SR, Annex XII thereto sets out detailed rules for keeping in balance the Pension Scheme of the European Officials (PSEO).

[2] The benefits to be paid under PSEO are laid down in Chapter 3 of Title V and Annex VIII SR. Benefits under the PSEO include retirement pensions, transfers of pension rights, severance grants, survivor's pensions and invalidity allowances.

law has confirmed that the PSEO is a notional fund, despite finding that it also displays some features of a solidarity scheme[3].

The PSEO is different from most Member State pension schemes for public officials, in which the contribution rate or benefits are adjusted so as to ensure a balance each year between contributions collected and pension expenditure. In this type of schemes, if it is not possible to achieve a balance, the difference is covered from the budget (taxes).

The notional PSEO fund is assessed both annually and every five years as if a real fund existed; thus further guaranteeing its long-term sustainability.

2.3. Actuarial balance principle

The balance of the PSEO is ensured regularly through updates of the contribution rates and, where relevant, pensionable age.

The PSEO follows an actuarial balance principle whereby annual staff contributions have to cover one third of the rights acquired in the year in question[4], which correspond to the future pensions that the same staff will receive after retirement, plus (under certain conditions) invalidity allowances and survivor's and orphans' pensions. In order to make this computation[5] possible, the contributions are evaluated at present value using an interest (discount) rate. The computation is thus an actuarial valuation.

The pension contribution rate is the mechanism that keeps the scheme in balance from year to year. It is automatically updated if the actuarial assessment foreseen by Article 83a of the Staff Regulations shows that this is necessary in order to fully cover the pension rights acquired in a given year. Consequently, when staff members pay the updated contribution rate, they acquire pension rights for a given year protected by the principle of acquired rights.

3. 2013 REFORM OF THE SR

In recent years, the European public administration has undergone two successive far-reaching reforms. The 2013 reform of the Staff Regulations included a number of measures which impacted the functioning of PSEO and resulted in significant savings:

- Increased retirement age (up to 66 years),
- Reduction of the pension accrual rate (from 1.9% to 1.8%),
- Two-year freeze of all salaries, pensions and allowances in 2013 and 2014 and retroactive decision to reduce salary adjustments to a minimum in 2011 and 2012[6]. As

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[3] See, for example, Case F-105/05 *Wils v Parliament*, point 85 and Case T-439/09 *Purvis v Parliament*, point 45.

[4] Article 83(2) SR.

[5] The pension contribution rate is computed according to the 'projected unit credit' method, as prescribed by international accounting standard IPSAS 25 (replaced by IPSAS 39 with effect on 1 Jan 2018). The sum of the actuarial values of rights acquired by active members of staff (referred to in actuarial practice as 'service cost') is compared with the annual total of their basic salaries in order to calculate the contribution rate.

[6] Salary adjustments were reduced to respectively 0% and 0.8% in 2011 and 2012 pursuant to Regulations (EU) No 422/2014 and No 423/2014 of the European Parliament and of the Council of 16 April 2014.

a result of the non-application of the salary update method, the parallel evolution of purchasing power with national civil servants was not maintained during these years,

- Reduced career progression for AD and AST staff, with limited access to highest grades,

- Creation of a lower salary scale for secretarial and clerical jobs, effectively reducing their remuneration by 13 to 40%,

- Increase of working time for all staff by 2.5 hours a week to 40 hours, without any financial compensation.

In addition, the 2013 reform of the Staff Regulations introduced a number of measures designed to improve the functioning of the system:

- In line with the relevant accounting standards[7] and best actuarial practices which require a period of past observations in line with the estimated term of post-employment benefit obligations to be used for interest rates and salary growth with a view to ensuring the balance of pension schemes, the moving averages for observing PSEO interest rates and salary growth were extended to 30 years with a transitional period of seven years,

- In order to remedy the difficulties with the application of the adjustment method in the past, provisions were made for a method allowing for an automatic annual update of the pension contribution rate. To this end, the pension contribution rate is updated regularly without the intervention of a legal act. The Commission then publishes the updated rate within 2 weeks after the update in the C series of the Official Journal of the European Union for information purposes,

- The 2013 reform of the Staff Regulations established pensionable age as the second variable for balancing the system, in order to take due account of future demographic changes. In particular, the Commission was mandated to carry out a five-yearly assessment of pensionable age, taking into account developments affecting Member States' civil servants and EU staff's life expectancy[8]. The Commission is due to deliver its first report to the European Parliament and the Council in 2019.

4. TECHNICAL IMPLEMENTATION OF THE RULES FOR KEEPING PSEO IN BALANCE (2014-2018)

Eurostat is the authority responsible for the technical implementation of Annex XII to the Staff Regulations. It is assisted by one or more qualified independent experts in carrying out the actuarial assessments of PSEO. Methodology questions raised by the implementation of the Annex are dealt with by Eurostat in cooperation with national experts from the Member States, which convene in a group (the Article 83 Working Group) at least once each year.

[7] IPSAS 25, Articles 91 and 96.
[8] Article 77(6) and 77(7) of the Staff Regulations.

4.1. Activity of the Article 83 Working Group in the period 2014-18

In the 2014-2018 period, the Article 83 Working Group met each year as required by the Staff Regulations. The group discussed and validated the methodological documents drawn up by Eurostat.

Eurostat also exchanges relevant information on actuarial issues with international organisations such as the ISRP (International Service for Remunerations and Pensions of the Coordinated Organisations, including the OECD, NATO, ESA, the Council of Europe, and others), the European Central Bank, the European Investment Bank, the European Investment Fund, the European Patent Office and Eurocontrol.

4.2. Assessments by the qualified independent expert

In accordance with Article 13(2) of Annex XII to the Staff Regulations, Eurostat is assisted by a qualified independent expert with regard to the methodological implementation and to the definition and calculation of the corresponding actuarial assumptions.

Following the outcomes of open call for tenders, Eurostat was assisted by:

- EY Actuaires Conseils for the PSEO assessments 2014 to 2016;
- the Consortium of Agilis S.A. and Prudential Ltd. for the PSEO assessments 2017 and 2018.

Both actuaries reviewed and validated the methodology, calculations and reports related to the PSEO assessment. In particular, the input for calculations, such as the PSEO population and actuarial assumptions, were agreed with those external experts.

The final assessment reports delivered by Eurostat incorporate the recommendation of those actuaries.

The actuaries perform independent parallel calculations of the PSEO pension contribution rate and deliver an actuarial opinion, which can be either "unqualified" or "qualified" (the latter happens when the actuaries' results differ from Eurostat's results by more than the tolerated materiality threshold of 3%).

In the case of all the PSEO assessment reports issued between 2014 and 2018, the actuaries released an "unqualified" opinion.

5. PARAMETERS AND ACTUARIAL ASSUMPTIONS

5.1. Statutory parameters

These are values mainly linked to the application of the Staff Regulations, including the rules on calculating pension benefits.

Some of these parameters change according to certain conditions related to the individual situation of each official[9], e.g.:

- The annual accrual rate is 1.8% for staff recruited from 1 January 2014, 1.9% for staff recruited between 1 May 2004 and 31 December 2013 and 2% for those recruited till 30 April 2004,
- The "normal" pensionable age when staff may retire without reduction of pension benefits varies from 60 to 66,

[9] See Annex XIII to the Staff Regulations.

- Compensations are foreseen for staff members who remain in service after reaching their pensionable age (Barcelona incentive), whereas penalties apply in the case of early retirement before reaching pensionable age.

Table 1 provides the list of the main statutory parameters used for the last pension assessment in 2018.

Table 1 - Main statutory parameters used in the actuarial assessment in 2018

Parameter	Value
Legal source	Staff Regulations in force from 01.01.2014
Reference date for the population (Annex XII Article 1)	31.12.2017
Maximum official retirement age (Staff Regulations Article 52)	65 (automatically - officials in service before 01.01.2014), 66 (automatically new officials) or 67 (at the staff' request) or until 70 (exceptionally)
Normal retirement age (Staff Regulations Article 52 and Annex XIII Article 22)	60 to 66 depending on years' service, age and entry date in service
Minimum retirement age (Staff Regulations Article 52(b), Annex VIII Article 9 and Annex XIII Article 23)	58
Category and grade for the minimum subsistence figure (Annex VIII Article 6)	first step of grade 1
Maximum retirement pension (Staff Regulations Article 77)	70% of the basic salary at the retirement date
Annual accrual rate (Article 77 of the Staff Regulations and Article 21 of Annex XIII)	1.8% (officials in service from 01.01.2014), 1.9% (officials in service from 1.05.2004), or 2% (officials in service before 01.05.2004), of BS
Bonus for officials in service after the normal retirement age (Annex VIII Article 5 and Annex XIII Article 22)	1.5% (new officials) or 2.5% of the BS, or 5% of the amount of the pension rights acquired at 60, depending on the entry date in service, the years of service at 01.05.2004 and the age on 01.05.2004 of the official
Minimum retirement pension (Staff Regulations Article 77)	4% of the minimum subsistence figure per year of service
Invalidity allowance (Staff	70% of the basic salary

Regulations Article 78)	
Minimum invalidity allowance (Staff Regulations Article 78)	100% of the minimum subsistence figure
Reversionary pension (Staff Regulations Article 79 and Annex VIII Article 18)	60% of the retirement pension
Minimum reversionary pension (Staff Regulations Article 79 and Annex VIII Article 18)	35% of the last basic salary
Survivor's pension (Staff Regulations Article 79 and Annex VIII Article 17)	60% of the retirement pension that would have been payable to the official
Minimum survivor's pension (Staff Regulations Article 79)	35% of the last basic salary or minimum subsistence figure

5.2. Actuarial assumptions

These are values that must be forecasted in accordance with the provisions of the Staff Regulations and the best commonly accepted actuarial practices.

The values of these actuarial assumptions were estimated according to general actuarial practices and were agreed with national experts from the relevant departments of the Member States at the meetings of the Article 83 Working Group.

In accordance with the provisions of Annex XII to the Staff Regulations and decisions taken by the Working Group, some of these assumptions (e.g. the mortality table) are only updated on the occasion of the five-yearly assessment of the scheme while others are updated every year. The latest five-yearly assessment took place in 2018.

5.3. Demographic assumptions

The main demographic actuarial assumptions are as follows:

– The mortality tables: The 2018 EU Life Table (EULT), developed by Eurostat, is a prospective table which incorporates a trend of life expectancies over a 20 years' time horizon (same time length as the PSEO duration) based on the evolution of mortality of the PSEO population. The 2018 EULT is thus a life table built on a population entirely relevant to PSEO.

Table 2 is an extract from the EULT.

Age	Men		Women	
	Probability to die at age x	Life expectancy	Probability to die at age x	Life expectancy
40	0.00052220	44	0.00040251	47
45	0.00089611	39	0.00069129	42
50	0.00151059	35	0.00118716	37
55	0.00254589	30	0.00203834	32
60	0.00428923	25	0.00349874	27
65	0.00691083	21	0.00600232	23
70	0.01268196	17	0.00923173	19
75	0.02321581	13	0.01561910	15
80	0.04230976	10	0.02977824	11
85	0.07648061	7	0.05640000	8
90	0.13322851	5	0.10771240	5

- The invalidity tables developed by Eurostat based on past observations,
- The assumed retirement age; in accordance with Article 4(3) of Annex XII to the Staff Regulations, it is assumed that retirements will occur at a fixed average rate that varies based on the date of entry into service of each staff member,
- The probability of being married at the retirement date,
- The coefficients for orphans and divorced spouses, etc.

Table 3 provides the list of demographic assumptions used for the last pension assessment in 2018.

Table 3 – Demographic assumptions used for the actuarial assessment in 2018

Demographic assumptions	31/12/2017
Life Table (healthy members)	2018 EULT
Life Table (disabled members)	2018 EULT+3y
Invalidity Table	2018 Invalidity Table
Current Marital Status	Current marital status
Probability of being married at retirement age, for men	82%
Probability of being married at retirement age, for women	52%
Average age difference between an official and his/her partner	1 year

Assumed Retirement Age	63 to 66
Turnover	2018 Turnover

5.4. Financial and economic assumptions

Pursuant to Articles 10 and 11 of Annex XII to the SR, the Real Discount Rate (RDR – interest rates of long term public debt of Member States) and the General Salary Growth (GSG – the rate of annual change in the salary scales) are calculated as the moving average of the corresponding rates for the 30 preceding years. However, until 2020, pursuant to Article 11a of Annex XII the moving average shall be calculated on the basis of a specific time scale.

In 2018, the RDR and the GSG were calculated as the average of the relevant rates for the 24 previous years from 1994 to 2017: as a result in the 2018 update the values of the RDR and GSG were respectively 2.9% and - 0.1%.

Another important economic assumption is the ISP (individual salary progression) table which refers to the salary increase reflecting the career advancement of EU officials (i.e. promotions and seniority steps). With the entry into force of the new Staff Regulations on 1 January 2014, the career progression of EU officials evolved and the link between grade and function was reinforced; access to the highest grades in function groups AD and AST is now limited under certain conditions. In addition, the AST/SC function group was introduced.

Table 4 provides the list of economic and financial assumptions used for the last pension assessment in 2018.

Table 4 – Economic and financial assumptions used for the actuarial assessment in 2018

Financial Assumptions	31/12/2017
Salary Grid	In force from 01.07.2017
Duration	20 years
Nominal Discount Rate (NDR)	4.8%
Inflation Rate (IR)	1.8%
Real Discount Rate (RDR)	2.9%
General Salary Growth (GSG)	-0.1%
General Pension Revaluation (GPR) (equal to GSG)	-0.1%
Individual Salary Progression (ISP)	2018 ISP Table
Coefficient for orphan's and divorced spouse's pension	13%
Correction coefficients (Art. 3(5) of Annex XI & art. 20 of Annex XIII)	0.0%

6. RESULTS: EVOLUTION OF THE PENSION CONTRIBUTION RATE

6.1. Pension assessments between 2014 and 2018

During the period 2014-2018, in order to guarantee balance of the scheme, the pension contribution rate was calculated as one third of the ratio between the total service cost and the total annual basic salaries, in accordance with Article 83(2) of the Staff Regulations.

Table 5 provides the results of every assessment since 2014.

Table 5 – Pension contribution by year between 2014 and 2018

Items	Pension assessments				
	2014	2015	2016	2017	2018
	Reference date				
	31-12-2013	31-12-2014	31-12-2015	31-12-2016	31-12-2017
Service cost for retirement	28,3%	28,2%	27,2%	27,1%	27,4%
Service cost for invalidity	1,3%	1,3%	1,3%	1,3%	1,7%
Service cost for death	0,9%	0,9%	1,0%	0,9%	0,9%
Ratio service cost / BS	**30,4%**	**30,5%**	**29,5%**	**29,3%**	**30,0%**
Officials' contribution rate (1/3 of total ratio)	**10,1%**	**10,2%**	**9,8%**	**9,8%**	**10,0%**
Applied officials' contribution rate	**10,1%**	**10,1%**	**9,80%**	**9,80%**	**10,0%**

6.2. Results of the last pension assessment

The 2018 actuarial assessment of the PSEO indicates that, in order to ensure the balance of this pension scheme, the contribution rate necessary to finance one third of the benefits payable is 10.0% of the basic salary (or of the invalidity allowance).

The calculated contribution rate indicated above (10%) is one third of the ratio between the total of the service cost (€ 1 424.8 million) and the total of annual basic salaries (€ 4 749.2 million). This rate is *higher* (+0.2%) than the one calculated in 2017 (9.8%).

In accordance with Article 83a(3) of the Staff Regulations, the reference figure set out in Article 83(2) shall be updated. The Commission shall publish the resulting updated rate of contribution (10.0%) within two weeks after the update in the C series of the *Official Journal of the European Union* for information purposes.

The update shall take effect at the same time as the annual update of remuneration under Article 65 of the Staff Regulations, i.e. it will take retroactive effect on 1 July 2018.

7. BALANCE OF THE PENSION SCHEME

As explained in part 2.3 of this report, the PSEO is in balance if the annual contributions paid by the staff cover one third of the rights acquired during the year, i.e., according to the Staff Regulations, as regards a retirement pension, 1.8%, 1.9% or 2% of the final basic salary before retirement. As the pension contribution rate is calculated to guarantee that the scheme is in balance, the scheme is in balance when the calculated rate is applied.

During the reference period of this report, based on the Eurostat's calculated rate of contribution, the pension contribution rate was updated after taking into account the specific provisions of the Staff Regulations:

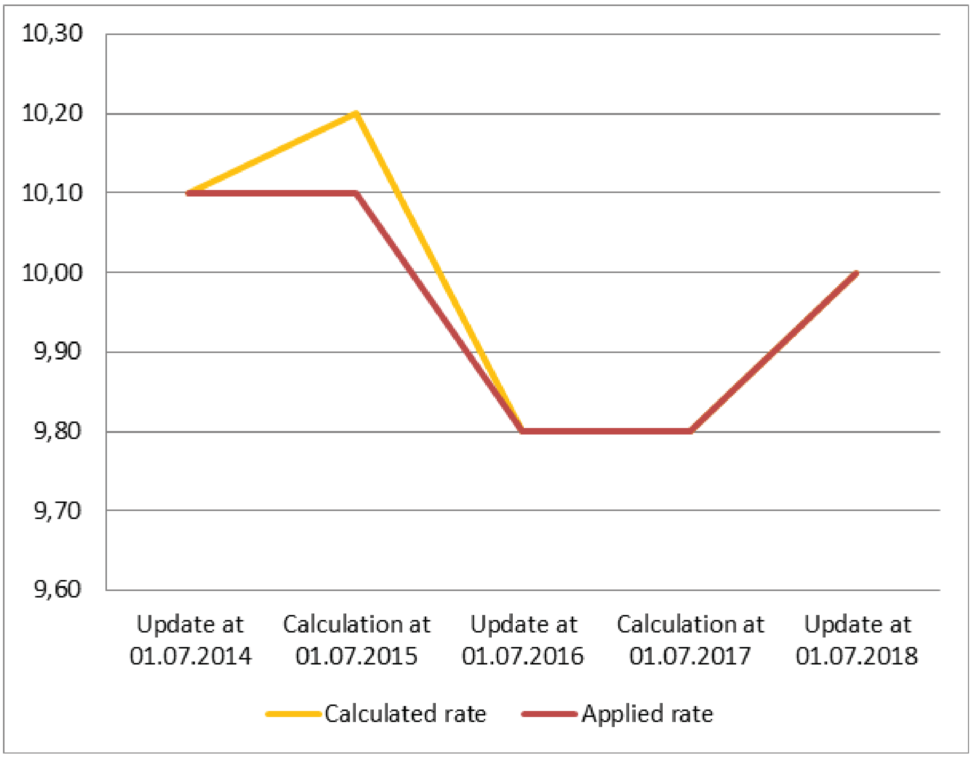
– Article 2(1) of Annex XII to the Staff Regulations (any update shall not lead to a contribution being more than one percentage point above or below the valid rate of the previous year);

– Article 2(2) of Annex XII to the Staff Regulations (the difference established between the update of the contribution rate which would have resulted from the actuarial calculation and the update resulting from the variation referred to in the last sentence of paragraph 1 shall not be recovered at any time, or, consequently, taken into account in subsequent actuarial calculations);

– Article 83a(4) of the Staff Regulations (on the occasion of the yearly updates of the five-yearly actuarial assessment, the rate of contribution shall only be updated if there is a gap of at least 0.25 points between the rate of contribution currently applied and the rate required to maintain actuarial balance. This limit does not apply on the occasion of a five-yearly assessment such as the 2018 assessment).

Graph 1 summarises the calculated and applied contribution rates.

Graph 1 – Summary of calculated and applied contribution rates for pension



The chart shows that the applied pension contribution rate was very close to the one calculated by Eurostat. It should be noted that small differences between the rates due to the application of the above mentioned provisions of the Staff Regulations can be positive or negative; these differences tend to cancel each other out in the long term.

Therefore, the method has fulfilled its specific aim to guarantee that the pension contribution paid by staff to the budget covers one third of the cost under the pension scheme, as specified in Article 1(1) of Annex XII to the Staff Regulations, and, hence, the PSEO scheme is in actuarial balance.

8. BUDGETARY IMPACT OF PSEO

In the 1960s the Council decided that staff contributions would not be set aside in an actual pension fund, but would instead be credited to the EU budget at the time when they are collected and spent in accordance with the decisions of the budgetary authority, i.e. not assigned to any particular policy field. At the same time, the Council decided that the employer's share of the contribution would not be collected. Instead, the EU institutions undertook to pay future pension benefits (to be charged to the Union budget) when staff retire.

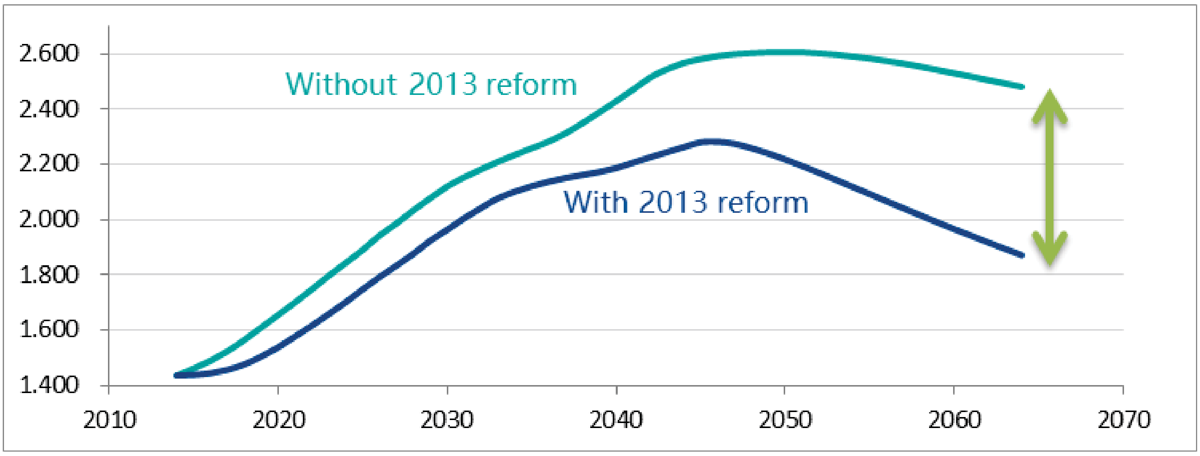
In budgetary terms the EU pension scheme has thus produced net revenue in the past, as it is not yet mature, i.e. the contributions from active staff acquiring pension rights have outweighed the benefits drawn by a limited number of retirees. Pension scheme revenue has consisted of staff and employer contributions; the latter were not paid into a fund, but only reflected in the pension liability. In this way, the **EU budget was actually borrowing money from scheme members in return for a guarantee to pay future benefits**.

Due to the growth of the EU and its workforce since the creation of the pension scheme in the 1960s, the net number of pensioners (difference between number of staff retiring and pensioners passing away) has increased and will keep increasing over the next Multiannual Financial Framework (MFF). Although in the long-term pension expenditure will be substantially reduced thanks to the successive reforms, these reforms were subject to transitional provisions given that pension rights are protected under the principle of acquired rights. Therefore, the **budgetary effects of the reform on pension expenditure only appear progressively over time**. As a consequence, due to the lack of maturity of the PSEO, the increasing trend of pension expenditure is due to continue until the 2040s.

The considerable pension savings that will be generated by the reform (see graph 2) was confirmed in 2016 by a Eurostat study of the long-term budgetary implications of pension costs[10]. This study was welcomed by the Member States as an objective and realistic assessment of the situation. Eurostat found that the 2013 reform would **reduce the long-term pension bill by approximately 30%,** on top of savings from the previous overhaul of the pension scheme in 2004. Following this Eurostat study, several Member States stressed the importance of pension provisions when ensuring that the EU remains an attractive institution for applicants from all Member States and especially those with relatively high per capita incomes.

Furthermore, the two successive far-reaching Staff Regulations reforms were put in place in a very short period (i.e. as of 2004 and 2014), which also imposed the legal necessity to introduce **transitional measures** in their implementation that concern large parts of the staff currently in service. In addition to these legal constraints, further changes to the existing rules at this point in time would additionally undermine the certainty and predictability concerning working conditions and pension benefits. This would likely further hinder the institutions' capacity to address the significant geographical imbalances observed.

Graph 2 – Evolution of long-term pension costs (figures in EUR million at constant prices) according to 2016 Eurostat study



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9. CONCLUSIONS

The implementation of Annex XII to the Staff Regulations by the Commission ensured stability of the PSEO and the balance of the notional fund while the 2004 and 2013 Staff Regulations reforms are successfully implemented, increasing progressively yearly savings.

In view of the above, the application of Annex XII to the Staff Regulations has fulfilled its specific aim to guarantee that the PSEO is in balance, as the pension contribution paid by the staff to the budget covers one third of the rights acquired every year due to the following reasons:

- the contribution rate calculated by Eurostat covered one third of the pension rights acquired that year;
- the calculated contribution rate was validated by national experts and qualified independent experts;
- the applied contribution rate was very close to the calculated one;
- small differences between the calculated and applied rates were due to the specific provisions of the Staff Regulations. As these differences can be positive or negative, they tend to cancel each other out in the long term.

The co-legislators decided that the present report should focus on the 2014-2018 actuarial balance of the pension scheme and not on the future evolution of pension expenditure. By contrast, it should be mentioned that in its proposal for a Council Regulation laying down the next MFF the Commission presented the expected expenditure for the period 2021 – 2027 based notably upon the yearly growth of pension expenditure as presented in part 8. On this occasion, the Commission also undertook to reflect on the feasibility of the creation of a capital-based pension fund for EU staff in the framework of the mid-term review of the MFF in 2023.