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Article

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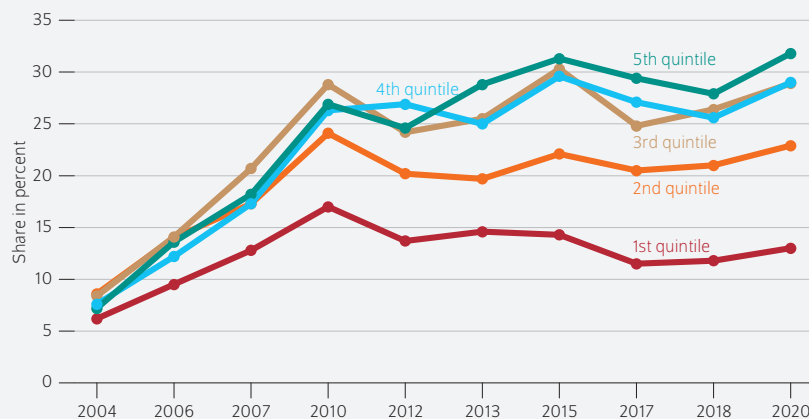
AT A GLANCE

20 years of the Riester pension—personal retirement provision requires reform

By Johannes Geyer, Markus M. Grabka, and Peter Haan

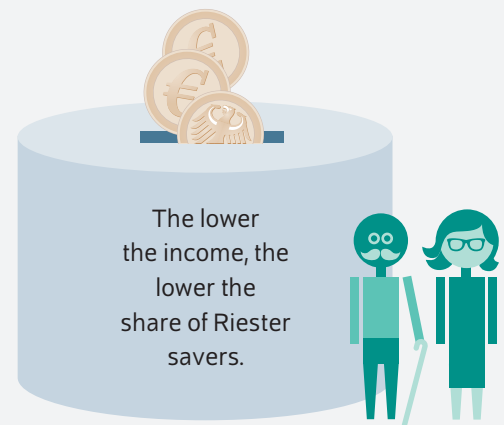
- Use of Riester contracts is stagnating at around a quarter of the working-age population 20 years after its introduction
- Major discrepancy by income: only 13 percent of poor individuals have a Riester contract compared to 32 percent of the richest individuals
- Differences by income are increasing over time
- For current recipients, Riester pensions account for about five percent of income—which is increasing, but not enough
- In order to fulfill its function, the Riester pension would have to be fundamentally reformed into a mandatory pension fund based on the Swedish model

Not attractive for low-income earners: the Riester pension does not achieve its goals



Sources: SOEP Core v36 as well as preliminary data from 2020.

Note: Adults up to 65 years old in private households. There is no data available on the Riester pension for the years not included. Equivalized income using the OECD-modified scale.



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FROM THE AUTHORS

“The Riester pension is struggling to reach important target groups. Those who need a Riester pension the most because they are threatened with old-age poverty rarely have contracts. If the Riester pension is to be a significant component of old-age provision in Germany, comprehensive reform is necessary.”

— Peter Haan —

MEDIA



Audio Interview with – P. Haan (in German)
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20 years of the Riester pension—personal retirement provision requires reform

By Johannes Geyer, Markus M. Grabka, and Peter Haan

ABSTRACT

Introduced 20 years ago as a part of the 2001 pension reform, the Riester pension is meant to function as an essential component of the German pension system with the aim of compensating for decreasing public pensions. However, data collected by the SOEP show that this objective has not yet been achieved. For ten years, use of the Riester pension plan has been stagnating at around 25 percent of the working-age population, meaning the majority of households do not have a Riester contract. From a sociopolitical standpoint, the growing significant inequality in the use of the Riester pension is especially problematic. In 2020, only around 13 percent of individuals in the lowest income quintile had a Riester contract compared to almost 32 percent in the top quintile. Among pension recipients, the Riester pension has so far only played a minor role in securing their standard of living, accounting for just around five percent of their total retirement income. If the Riester pension is to function as an essential component of the German pension system, it must be fundamentally reformed. One reform possibility would be to organize personal pension provision via a mandatory pension fund, similar to the Swedish model of a standardized pension scheme product with low administrative costs. However, it must be guaranteed that low-income earners and the unemployed are able to pay the mandatory basic contributions.

The German Federal Government introduced the Riester pension in 2002 with the goal of subsidizing personal retirement provision with grants and tax benefits. According to figures from the Federal Ministry of Labor and Social Affairs (*Bundesministerium für Arbeit und Soziales*, BMAS), use of Riester contracts has been stagnating at around 16 million contracts since 2011, with an estimated fifth of them not being paid into actively.¹ Thus, Riester use is lagging significantly behind expectations. The outgoing German government began 2018 with the promise of fundamentally reforming the Riester pension, aiming to spur on use of this form of retirement provision.² However, a legislative process did not materialize and use continues to stagnate. Thus, Riester reform could again be a topic in the coalition talks following the 2021 federal election.

This form of state-funded private retirement provision has been on the receiving end of criticism since its introduction on January 1, 2002.³ For example, the high administrative and acquisition costs as well as the opacity of the contracts have been criticized. Many products generate positive returns exclusively through government funding, which amounted to around four billion euros in 2018 for the approximately eleven million people who received subsidies.⁴ On the other hand, providers are complaining about restrictive guarantee conditions in a low-interest environment. New contracts are threatened with financial ruin, as the maximum actuarial interest rate⁵ for life insurance policies will fall from the current 0.9 percent to 0.25 percent at the turn of the year 2021/2022. With this predetermined interest rate,

¹ German Bundestag, "Response of the Federal Government," *Bundestagsdrucksache* no. 19, 25586 (2020) (in German).

² Cf. The coalition agreement on the Federal Government's website (in German; available online).

³ For an overview, see, for example, the reports in the *Vierteljahrshäfte zur Wirtschaftsforschung* 2 (2012) (in German).

⁴ Cf. Information on the website of the Federal Ministry of Finance, which regularly compiles statistical evaluations on funding (in German).

⁵ The maximum actuarial interest rate is set by the Federal Ministry of Finance and determines the maximum interest rate an insurer may apply when calculating provisions. The lower this interest rate, the more difficult it is for insurers to achieve the full return of premium promised in the Riester pension, according to which the contributions paid in must be paid back to the customer again.

Table

Characteristics of Riester savers, 2020

| Characteristics | Share in percent |
|--|------------------|
| Share | 25.3 |
| Gender | |
| Men | 22.6 |
| Women | 28.0 |
| Number of children in household | |
| 0 | 21.5 |
| 1 | 29.6 |
| 2 | 38.4 |
| 3 or more | 38.1 |
| Age | |
| 25 or younger | 9.0 |
| 26 to 35 | 23.3 |
| 36 to 45 | 33.9 |
| 46 to 55 | 32.4 |
| 56 to 65 | 20.9 |
| Marital status | |
| Married | 30.9 |
| Single | 18.8 |
| Divorced | 21.9 |
| Widowed | 14.7 |
| Region | |
| Western Germany | 25.0 |
| Eastern Germany | 26.6 |
| Migration background | |
| None | 28.4 |
| Direct | 14.7 |
| Indirect | 18.2 |
| Housing situation | |
| Owners | 30.6 |
| Renters | 20.3 |
| Level of education | |
| No degree | 11.0 |
| Apprenticeship | 25.9 |
| Polytechnic degree | 36.2 |
| University degree | 27.1 |
| Number of years unemployed | |
| 0 years | 26.3 |
| Up to 1 year | 29.1 |
| Over 1 to 2 years | 24.3 |
| Over 2 to 5 years | 17.0 |
| Over 5 years | 13.6 |
| Gross earned income decile | |
| 1st decile | 16.6 |
| 2nd | 24.7 |
| 3rd | 27.3 |
| 4th | 28.8 |
| 5th | 32.6 |
| 6th | 31.9 |
| 7th | 32.1 |
| 8th | 29.9 |
| 9th | 29.6 |
| 10th decile | 32.7 |
| Total (in millions of people) | 12.9 |

Sources: SOEP Core v36 as well as preliminary data from 2020. Working-age persons between 17 and 65 in private households.

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the full return of premium in the Riester pension can hardly be met. As a result, various providers are likely to withdraw from new customer business. For example, the asset management company DWS announced it will no longer conclude any new Riester contracts as of July 1, 2021.⁶

The Riester pension also faces sociopolitical criticism. As the Riester pension was not introduced as mandatory, there is risk selection inherent to private insurance markets: People who are at risk of old-age poverty and who could especially benefit from an additional pension do not have Riester contracts. The objective of this study is thus to describe the characteristics of Riester savers and to demonstrate which factors limit access to the Riester pension.⁷ Moreover, the use and the characteristics of the Riester recipients among pensioners can now be analyzed almost 20 years following its introduction. The analyses use data from the Socio-Economic Panel (SOEP) at DIW Berlin, which were collected in cooperation with Kantar.

More women are Riester savers

According to SOEP data, around 12.9 million people, or 25.3 percent of the working-age population (17 to 65 years old), have a Riester contract as of 2020 (Table). Compared to the information from BMAS, which indicates 16.4 million contracts, the SOEP data reports a somewhat smaller figure. This can be attributed in part to the fact that in the BMAS data, the number of contracts is counted but one person can have multiple contracts of this kind. In addition, respondents who no longer actively pay into a Riester contract are more likely to forget to mention it in a corresponding question. Individuals who did not meet the criteria for government support at the time of the survey might not report their contract either.⁸

At 28 percent, women concluded a Riester contract more frequently than men (around 23 percent). This can be explained by the funding structure of Riester contracts (Box), as child allowances make them more attractive and they are used more often by women. Accordingly, the share of Riester savers increases with the number of children. Young adults up until 25 have a smaller share, as they are frequently still completing their education. At around a third, the highest share is for 36 to 55-year-olds. The share decreases to a good 21 percent in the oldest age group (56–65). As single people are frequently younger, their rate is also below average at around 19 percent. However, divorced and widowed people also have a below average share. While there are barely any

⁶ DWS, "DWS stellt Riester-Neugeschäft ein und setzt auf garantiefreie Produktlösungen," press release, June 17, 2021 (in German; available online. This applies to all other online sources in this report unless stated otherwise). Stuttgarter Versicherung also announced that it will discontinue its new customer business for Riester contracts as of August 1, 2021.

⁷ Cf. earlier DIW Berlin publications on the topic: Johannes Geyer, "Riester-Rente: Rezept gegen Altersarmut?" *DIW Wochenbericht* no. 45 (2011): 16–21 (in German; available online).

⁸ Therefore, it is not surprising that the actual number of people receiving subsidies is below the official number of contracts. According to the Federal Ministry of Finance (BMF), only around 11 million people received aid in the form of allowances and/or tax savings between 2016 and 2019.

Box

Background on Riester pension promotion

The BMAS regularly publishes data on the development of the subsidized Riester pension scheme. Since 2012, the figure has been around 16 million contracts, which has been declining slightly since 2017. The BMAS estimates that around one fifth of the contracts have been paused, meaning no contributions are being paid.¹

Not all people are eligible for subsidies at all times. However, because a good 89 percent of the population has a claim to statutory pension insurance, a majority of the population is dependent on supplementary retirement provision.² No attempt was made to use the SOEP data to determine which individuals were eligible for aid under Section 10a of the Income Tax Act at the time of the survey.³

¹ Also, a significant part of the contracts are canceled, see Michael Ziegelmeyer and Julius Nick, "Backing out of Private Pension Provision: Lessons from Germany," *Empirica* 40, no. 3 (2013): 505–539 (available online).

² Supplementary Report of the Federal Government on the Pension Insurance Report 2020 pursuant to Section 154 (2) SGB VI (Old-Age Security Report 2020): 15 (in German).

³ Eligible individuals include, among others, employees compulsorily insured under the statutory pension insurance scheme, civil servants, reduced earnings capacity pensioners, trainees, non-professional caregivers, mini-jobbers with an exemption waiver from their insurance, persons doing military or civilian service, compulsorily insured self-employed persons, and recipients of AIG I or AIG II. In addition, their spouses are eligible. For an estimate of this group based on previous data, see Stephan Fasshauer and Nora Toutaoui, "Die Anzahl des förderberechtigten Personenkreises der Riester-Rente – eine Annäherung," *Deutsche Rentenversicherung* 64, no. 6 (2009): 478–86 (in German).

The subsidies for Riester pensions consist of direct allowances and tax credits. It provides for an annual basic allowance of 175 euros (since 2018). For qualifying children, there is an allowance of 185 euros (born up to December 31, 2007) or 300 euros (born from January 1, 2008). The minimum personal contribution is four percent of the previous year's income subject to pension scheme contributions, but not more than 2,100 euros (including the allowance). In addition, there is an allowance of 200 euros for new contracts (born after January 1, 1983) signed before reaching the age of 25. Furthermore, at least 60 euros per year must be contributed by the contract holder to receive the allowances.

The Riester pension is taxed on a deferred basis.⁴ Contributions and allowances can be deducted as special expenses on the income tax return. Thereafter, the most advantageous regime is applied to determine whether a taxpayer is entitled to the allowances and deductions.

To receive the full allowance, the minimum personal contribution must be paid. BMF evaluations for 2017 show that about 52 percent of those receiving support receive their allowance in full, while about 20 percent receive less than 50 percent of the allowance.⁵

⁴ If a basic income in old age is drawn at the same time as a Riester pension, there is currently an allowance for the Riester pension of up to 100 euros per month. Thus, only income from a Riester pension above this threshold is counted towards basic income.

⁵ Cf. Information on the website of the Federal Ministry of Finance.

differences by region, migration background does make a difference: People with a direct migration background have Riester contracts less frequently than those without a migration background (15 percent vs. 28 percent).

Low-income earners conclude Riester contracts more rarely

In terms of education, those with a polytechnic degree most frequently have Riester pensions, around 36 percent. The higher the professional position, the more frequently a Riester contract is held. For example, 42 percent of employees with comprehensive management tasks have a Riester contract, in contrast with only 11 percent of unskilled workers and ten percent of the unemployed. The share of Riester savers also decreases with the length of unemployment, suggesting that income significantly explains use. This is also reflected in the amount of current gross earned income from a main job: Broken down by decile,⁹ it can be seen that low-income earners are below-average Riester savers. Beginning at the fifth decile, the rate of Riester savers is around one third.

⁹ The lowest decile indicates the income situation of the poorest ten percent of the employed population.

In addition, there are also differences according to the housing situation: People living in property they own are significantly more likely to have a Riester contract (almost 31 percent) than tenants (20 percent).

Differences by income increase markedly over time

The following section investigates the question of how the share of Riester savers has developed over time according to income position. To do so, the equivalized¹⁰ net household income is used instead of the gross earned income, as the former better describes the financial situation of a household. It is important to note that people without a current income may also have a Riester pension. Data from 2004 and onward is considered, as 2004 was the first year in which the SOEP collected information on Riester contracts. Quintiles of household net income are shown. Sorting the population by income level and dividing the results into five groups of equal size creates the quintiles. The first quintile describes the income situation of the lowest-earning 20 percent of the population.

¹⁰ Cf. the term *Äquivalenzeinkommen* in the DIW Berlin Glossary (in German; available online).

Following the introduction of the Riester pension on January 1, 2002, all income groups experienced noticeable growth. Between 2004 and 2010, the share of Riester savers tripled from almost eight to 25 percent. Since then, the share of Riester savers has stagnated at this level (Figure 1).¹¹ However, from its introduction there were major differences between the income groups: the lower the income, the lower the share of Riester savers. This pattern has markedly increased over time. In 2020, the Riester rate was only about 13 percent in the lowest quintile compared to almost 32 percent in the top quintile.¹² The available findings shed light on two important problems: Use of the Riester pension has fallen far short of original expectations, accounting for just a quarter of the working-age population, and thus cannot come close to closing the gaps that have opened up in the statutory pension insurance system. In addition, low-income groups hardly take advantage of state-subsidized retirement provision despite there being an urgent need for action among this group to counteract future old-age poverty.

Riester pensions accounts for around five percent of total retirement income

Almost twenty years have passed since the introduction of the Riester pension in 2002, during which savers were able to make provisions for the future. Therefore, it is worthwhile to look at the people who are already Riester pension recipients, although the number of Riester pensions is still relatively small. According to the SOEP, around 300,000 people received a pension from a Riester contract in 2020, with an average monthly gross Riester pension of 83 euros (Figure 2). At 60 euros per month, the median¹³ is lower. Differences between income groups are also evident in the group of pension recipients,¹⁴ as those in the first income quintile receive a pension of only a little over 50 euros, while those in the top quintile receive over 100 euros. This is also reflected in the level of education, as pensioners without higher professional qualifications only receive around 40 euros from their Riester pension, while those with a formal degree receive around 80 euros. At around 100 euros, men receive almost twice as much in Riester pensions as women (55 euros). Differences by region show that the gross pension from a Riester contract is around 90 euros in eastern Germany, which is about ten euros more than in western Germany. There are no relevant differences by housing situation.

It is also of interest how large the Riester pension share of total retirement income is. Measured by the mean, the share is just around five percent; measured by the median,

¹¹ This development is also reflected in the stagnation of the overall contract market (Box).

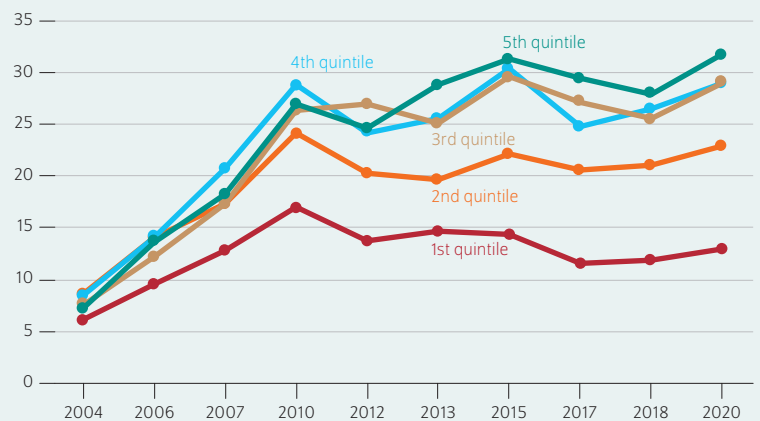
¹² This result confirms earlier studies. Compare with Johannes Geyer, "Riester-Rente und Niedrigeinkommen: was sagen die Daten?" *Vierteljahrshefte zur Wirtschaftsforschung* 81, no. 2 (2012): 165–180 (in German); Johannes Geyer and Viktor Steiner, "Zahl der Riester-Renten steigt sprunghaft: aber Geringverdiener halten sich noch zurück," *DIW Wochenbericht* no. 32 (2009): 534–541 (in German).

¹³ The median is the value that separates the richer half from the poorer half. Cf. the definition of the term *median income* in the DIW Berlin Glossary (in German; available online).

¹⁴ This is to be expected insofar as one's own contributions to the Riester pension are based on the amount of one's previous gross income and thus reflect the previous income hierarchy.

Figure 1

Share of Riester savers by current net household income In percent



Note: Adults up to 65 years old in private households. There is no data available on the Riester pension for the years not included. Equalized income using the OECD-modified scale.

Sources: SOEP Core v36 as well as preliminary data from 2020

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The lower the income, the lower the share of Riester savers.

it is only four percent. This means that the Riester pension has so far played only a minor role among current pensioners and is thus hardly able to close the gaps in the statutory pension system. While the importance of the Riester pension will increase for future pensioners due to longer saving phases than the current Riester pensioners, the analyses on the concluded contracts (see Table and Figure 1) show that this will not apply to all pensioners. In particular, pensioners who were unemployed for a long time, only have a low level of education, are single, or were low-income earners, will barely have any claim to Riester pensions.¹⁵ As a rule, these groups also have fewer claims to statutory pension insurance and are especially at risk of old-age poverty.

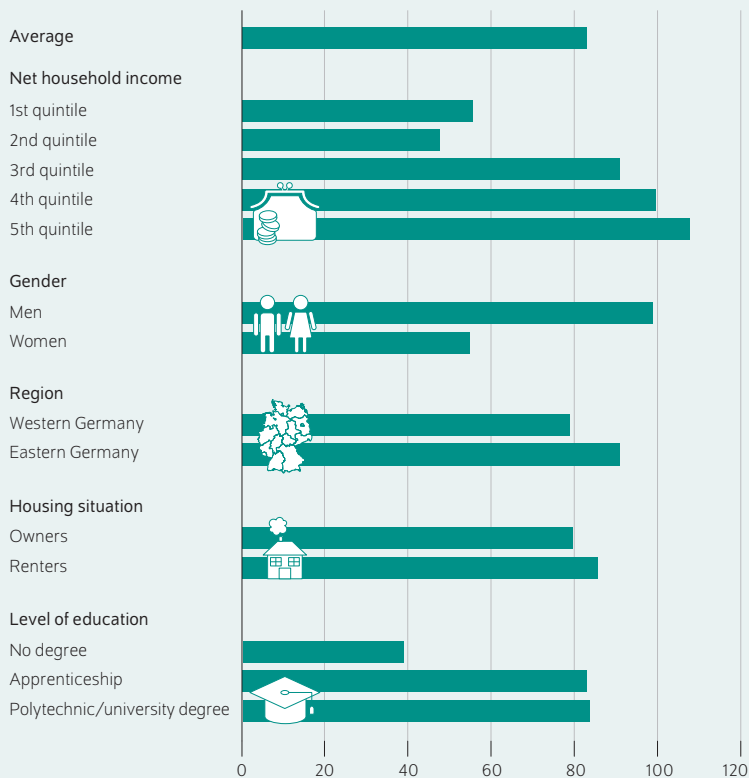
Conclusion: Riester requires fundamental reforms

Twenty years after the beginning of the multi-pillar system of old-age provision, the goals of the Riester pension have not been achieved and valuable time for reform has not been used. The Riester pension was originally conceived to function as an essential component of the retirement provision system, but high expectations were not fulfilled. According to SOEP, only around 25 percent of the working-age population has a Riester contract. Without four billion euros of government funding per year, use would be markedly lower. While the number of Riester contracts is certainly high compared to other private pension products, that should not be the only measure of success. Taking the primary function of the Riester pension into account—to supplement the

¹⁵ A large share of savers also save such low contributions that the government subsidies cannot be fully accessed (Box).

Figure 2

Gross pension withdrawal from a Riester pension, 2020 In euros per month



Note: Equivalized income using the OECD-modified scale.

Sources: SOEP Core v36 as well as preliminary data from 2020

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Pensioners who made provisions with a Riester contract currently receive an average of 83 euros of their retirement income from a Riester pension.

level of education have easier access to this market and take out pension contracts more frequently, in part due to tax deductibility, which is more attractive for higher incomes.¹⁶ The reverse is true for people with long periods of unemployment, a low level of education, and low income. Although they benefit from government support in particular, they are much less likely to have taken out Riester contracts and therefore only a small proportion of this group will receive pension payments. Generally, these groups also have lower claims to statutory and occupational pension schemes and are thus particularly at risk of old-age poverty. This is a central problem of social policy that will become even greater in the coming years.¹⁷ Thus, and with many providers ending new customer business, the Riester pension must be fundamentally reformed if it is to be a key component of the pension system in Germany. One possibility would be to organize a private pension scheme via a mandatory state pension fund, following the Swedish model of a standardized pension product with low administrative costs. Numerous proposals from various parties are already on the table for this. However, important sociopolitical and organizational issues need to be clarified in the proposals for a mandatory funded pension system. In particular, it must be guaranteed that low-income earners and the unemployed can afford the mandatory contributions. Here the state could intervene and take over or subsidize the contributions, similar to the way unemployment insurance also pays the pension contributions of the unemployed or the Riester subsidy supports households with low incomes. Alternatively, opt-out rules (meaning the possibility of being exempted from compulsory insurance at one's own request) are also being discussed. However, this poses the risk that those who will later need to rely on private pensions will opt out and thus have no claims in retirement. If the issue of low-income earners' contributions can be resolved, such a state pension fund could make an important contribution to stabilizing the German pension system.

statutory pension scheme to secure a standard of living—use should be closer to 90 percent, since this is the proportion of people who receive a statutory pension.

As might be expected, familiar patterns of insurance markets are also emerging. People with higher incomes and a higher

¹⁶ Giacomina Corneo, Johannes König, and Carsten Schröder, "Distributional Effects of Subsidizing Retirement Savings Accounts: Evidence from Germany," *FinanzArchiv* 74, no. 4 (2018): 415–445.

¹⁷ ¹⁷ The risk for old-age poverty will significantly increase in the coming years, see Johannes Geyer et al., *Anstieg der Altersarmut in Deutschland: Wie wirken verschiedene Rentenreformen?* (Gütersloh: Bertelsmann Stiftung, 2019) (in German; available online).

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