A STRATEGY FOR AN ADEQUATE AND SUSTAINABLE MALTESE PENSION SYSTEM

Pensions Strategy Group

June 2015

Outline of the Presentation

- Principles for Reform
- Impact of Proposed Reforms
- Main Recommendations

Principles for Reform

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- There needs to be a clear definition of the objectives of the Maltese pension system

- An adequate and sustainable pension system needs a strong active employment policy

- The state pension should be a solid foundation, but not the only source of retirement income

- To be socially sustainable, the system needs to provide a fair balance between contributions and benefits across generations

- To remain adequate and sustainable, the pension system needs to be able to evolve, particularly to respond to long term developments

Proposed Changes: Those Affected

- The 2007 reform divided the population into three groups: exempt (those born before 1952), transitional (those born between 1952 and 1961) and switchers (those born on 1962 and after).
- The 2016 reform should, as much as possible, retain the same approach; with those born before 1962 not much affected, and a gradual change for those born in later years.
- Moreover the reform also needs to look at the needs of current pensioners this is something the 2007 reform failed to do as it focused exclusively on future pensioners.

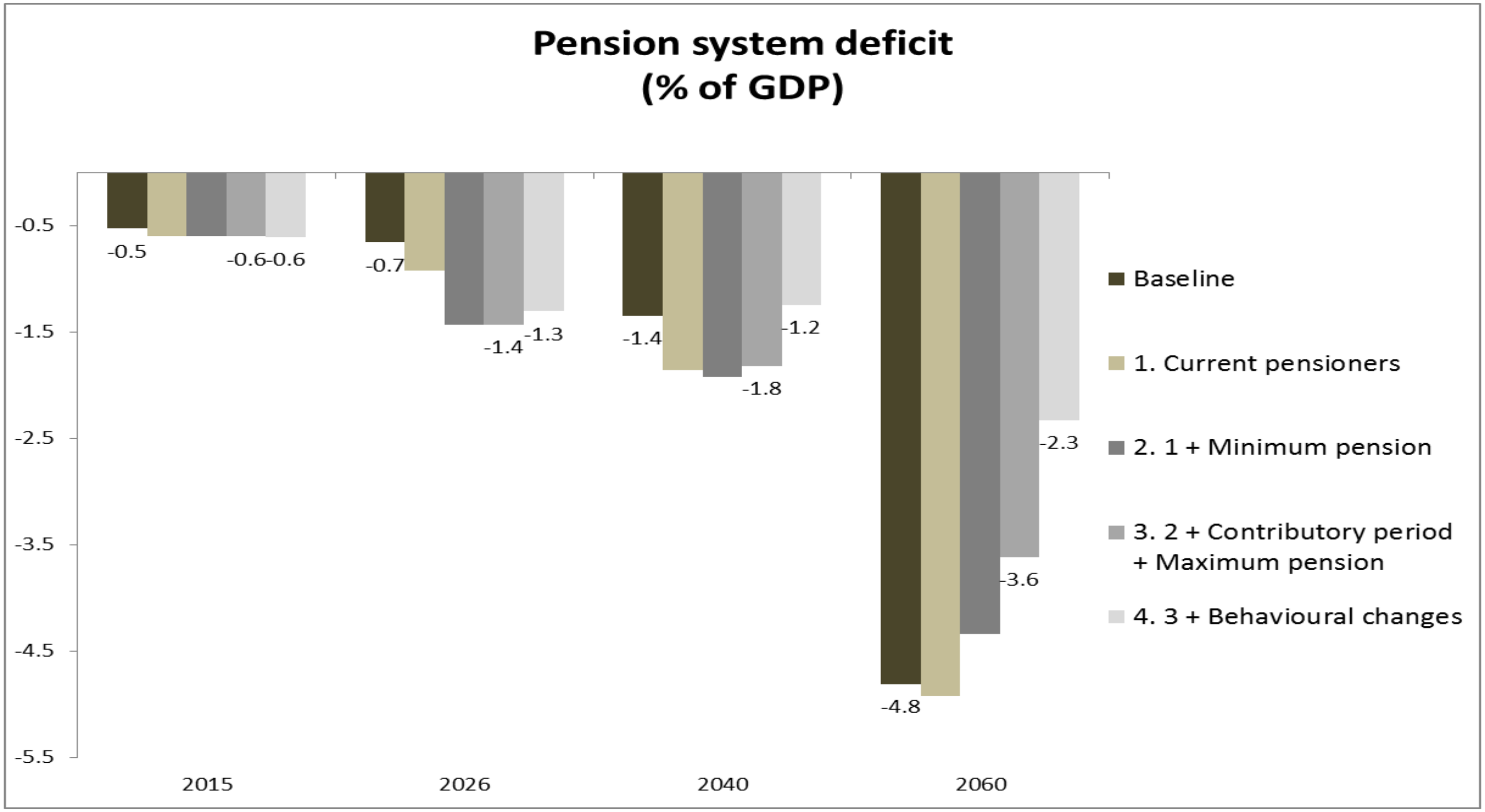
Impact of Proposed Reforms

Main Proposed Reforms

- Start the GNMP from 2016 gradually, but change the way it is assumed to increase over time after 2026.
- Shift indexation for current pensioners to higher of 50% increase in wages and 50% increase in prices or the COLA. Improve survivors' pensions.
- Introduce incentives for later retirement and reduce early exit.
- Allow people to retire at 65, but adjust contribution years to qualify for a full pension so that balance of contributions to benefits remains similar to that for current retirees. However, improve credits for women and those staying in education.
- Every five years there will be a reassessment of the main parameters to see if they remain adequate and sustainable.

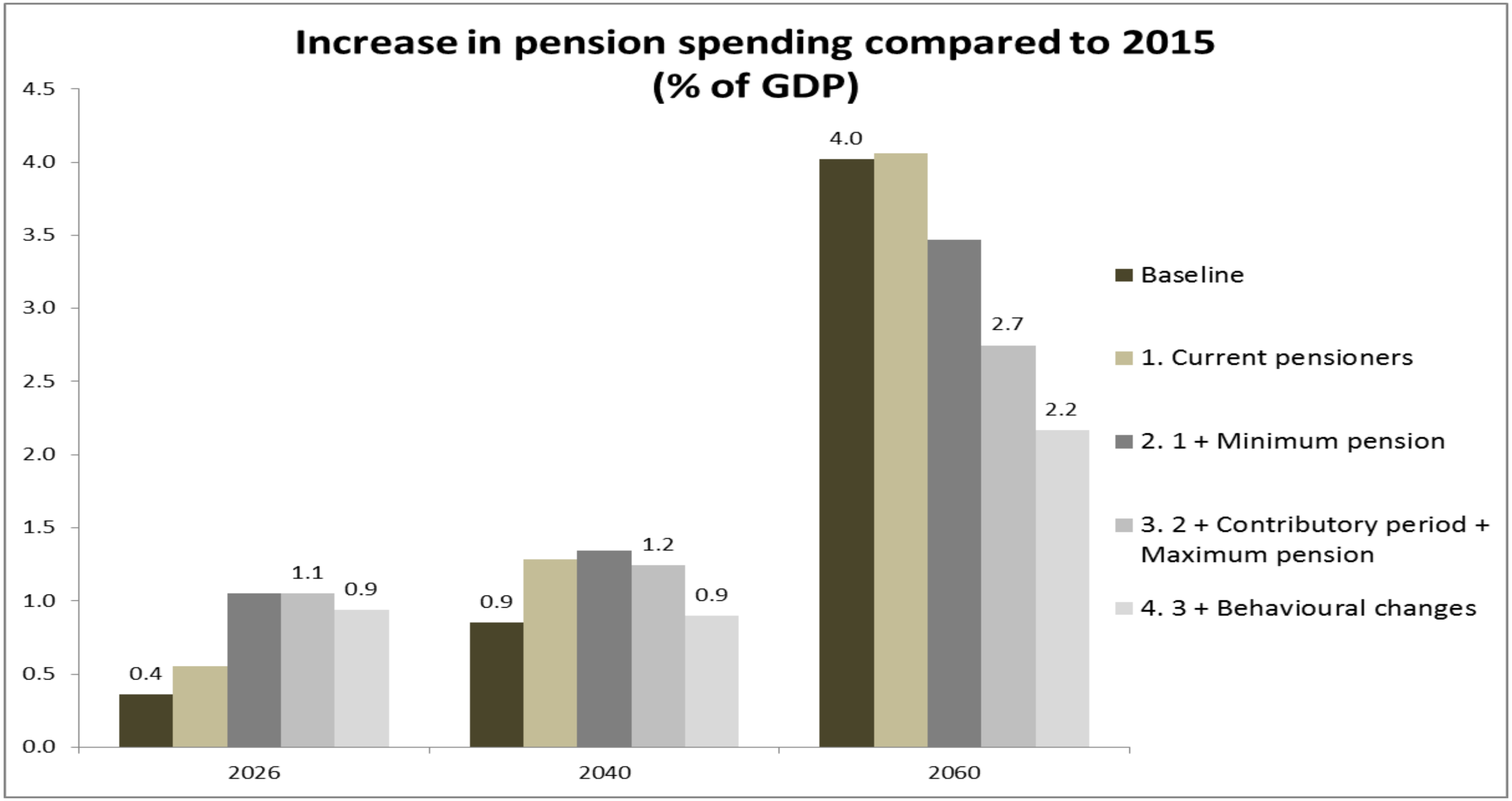
Future Pensioners: Impact Assessment (i)

- Initially the reforms would worsen slightly the system deficit, but after 2040 they would reduce the deficit by more than half.



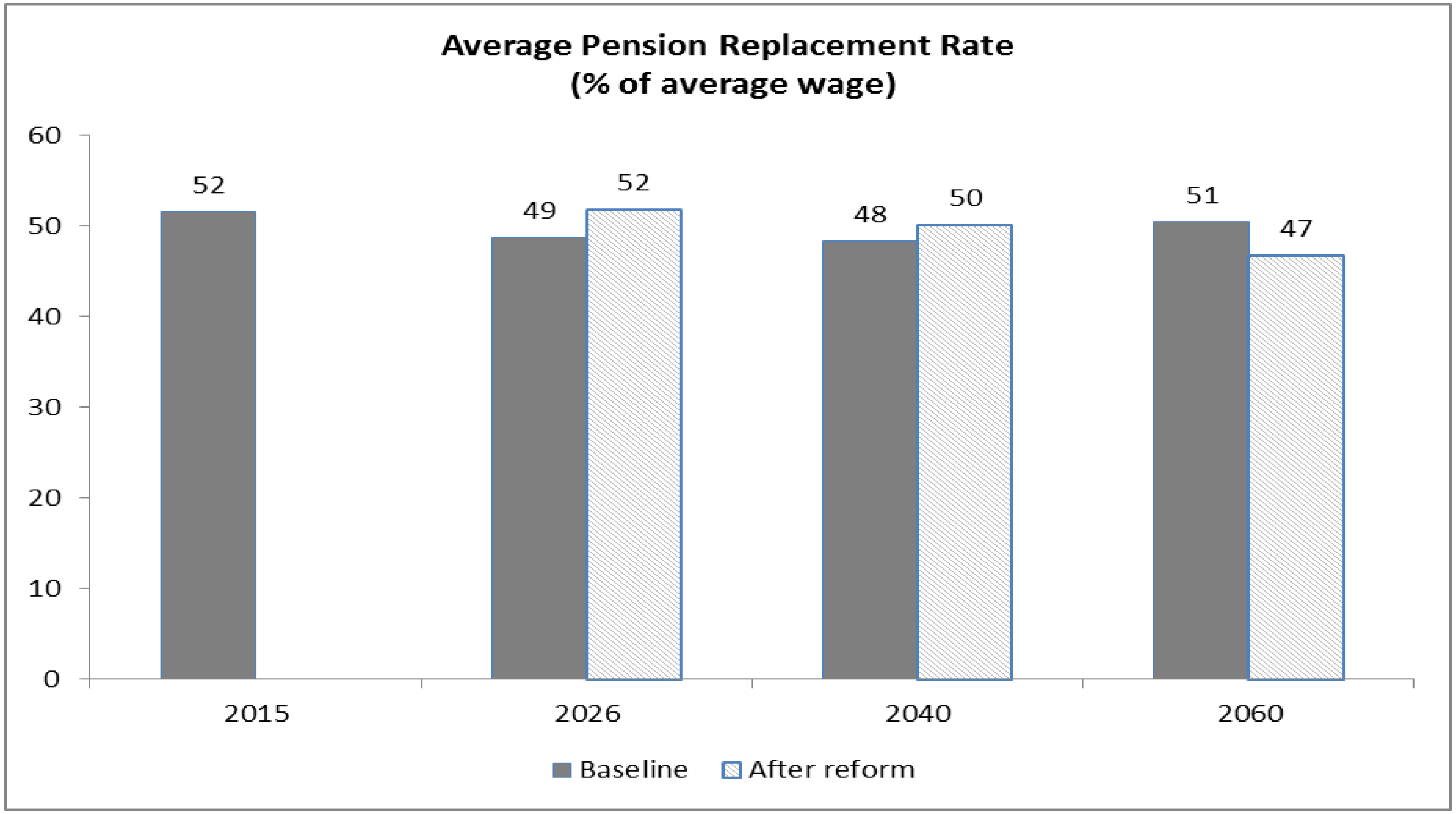
Future Pensioners: Impact Assessment (ii)

- Even with no behaviour changes measures reduce spending by 1.3% of GDP, and another 0.5% if behaviour changes.



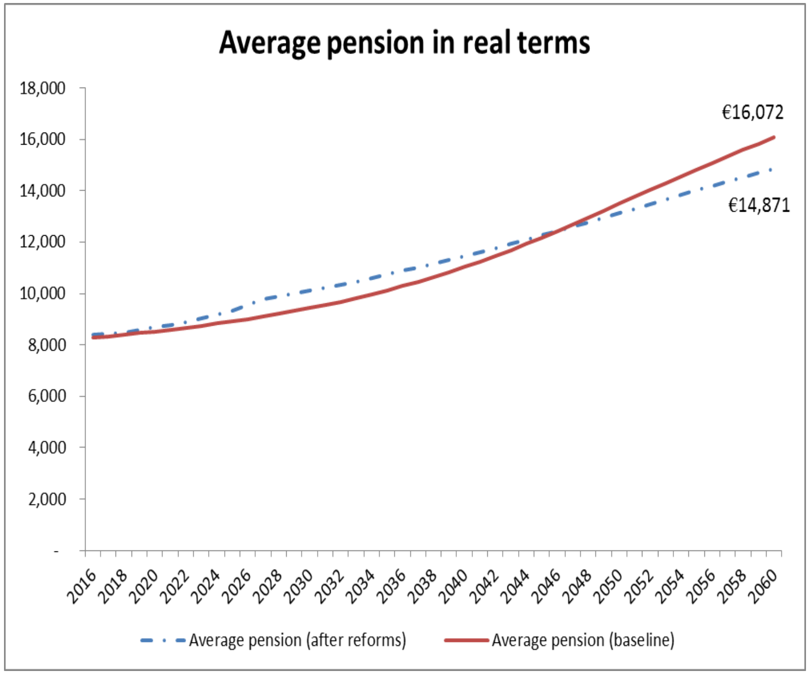
Future Pensioners: Impact Assessment (iii)

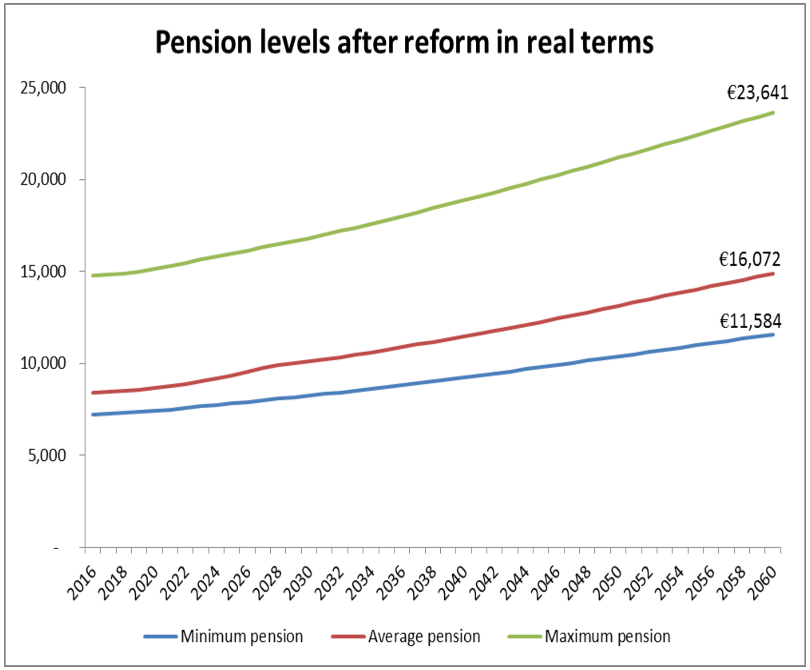
- Measures reduce overall generosity in 2060 by 4.9 percentage points, as against the decline of 9% projected in the 2007 pension reform. More than offset if individuals save in third pillar.



Future Pensioners: Impact Assessment (v)

- Though the replacement rate may decline in the long term, the average pension in real terms will be better till the 2040s. By 2060 though it will be 6% lower than under current rules, the average pension would still be 77% higher in real terms than it is now.





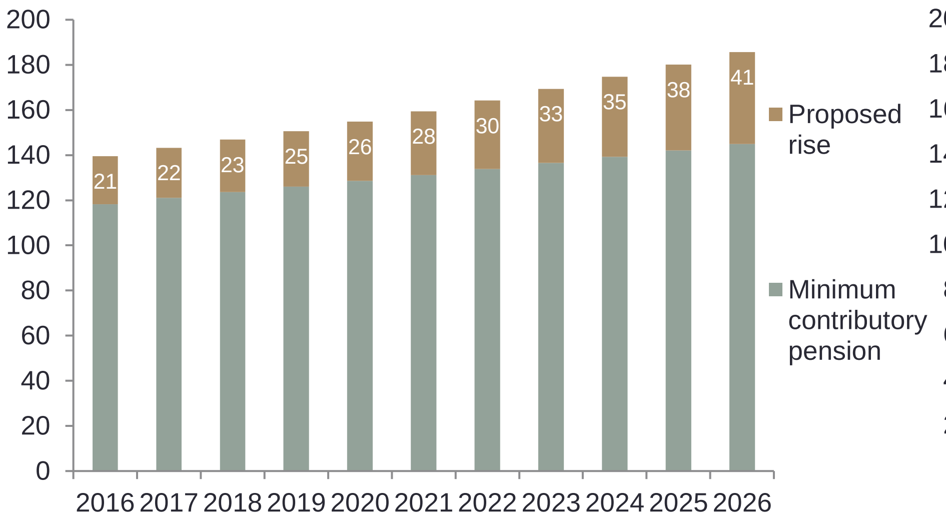
Main Recommendations

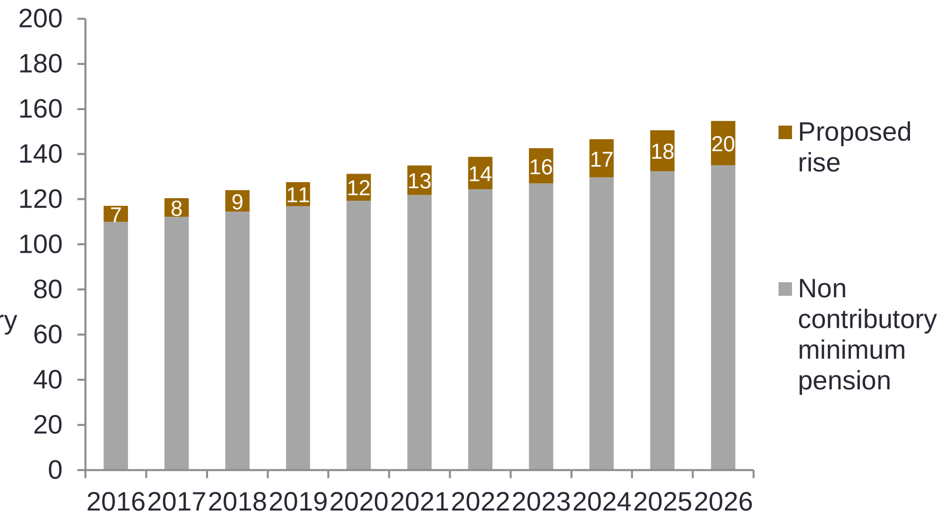
Defining Better the Minimum Pension

(Recommendations 15 & 16)

- The Group recommends that **the GNMP should be set at the relative poverty threshold in 2016 and annually increased till 2026 by COLA plus any difference between this amount and the indexation for other pensioners. Thereafter it would be increased by COLA plus any difference between this amount and the change in the maximum pension**. The non-contributory pension to be 67% of minimum wage for single recipients (80% for married) with full COLA.

Proposed rise in benefit per week





Current Pensioners: Minimum Pension

(Recommendations 15 , 25 & 26)

- The Group has estimated the cost of introducing the proposed GNMP for those born before 1962. The best option is for **the GNMP to be offered gradually, starting from 2016 for all those born in 1941 or before and gradually lower age of access every year so that those born in 1960 and 1961 would qualify for the GNMP in 2026.** Those born in 1962 or after already qualify for it from 2027 onwards.

- The cost to Government would be **0.15% of GDP** in 2016 (€12.4m), rising marginally to 0.16 of GDP% (€13.5m) in 2018. Cost is expected to peak at 0.56% of GDP in 2027 and decline thereafter. The initial impact on poverty should be **a reduction of 6.4%** in the poverty rate amongst the 75+, as about 18,000 individuals could benefit. The measure could generate **additional GDP of 0.12%** by 2027**.**

- The Group is also of the opinion that **the Survivors' Pension should be equal to the deceased's pension if a survivor has a right to a pension her/himself.** This would cost around 0.06% of GDP (or €4.6m) in 2016, rising to €5.2m in 2018.

Current Pensioners: Maximum Pension

(Recommendation 22)

- Proposal by pensioners' associations: Raise maximum pension for those born 1952 to 1962, to 7/8ths or to 3/4ths of the post-62 level

- Either measure would benefit 5,200 beneficiaries, of which 4,230 are men. These are the people with the highest pensions, nearly double the poverty threshold. The first option would cost €9.5m in the first year of implementation. The cost would peak at €188m, or 1.1% of GDP in 2035. The second option would cost a sixth less.

- Since the priority is to combat poverty, PSG recommends **not to accept proposal** by pensioners' associations.

Current Pensioners: Indexation

(Recommendation 23)

- The Group recommends to **change current post-retirement indexation so that** instead of being based on COLA and current salary changes**, pensions annual adjustments are based on 50% wages 50% inflation**.
- Current regime is unfair as 10% of pensioners only receive COLA while 20% receive increases that are more than double COLA.
- This measure would allocate the same amount of spending in a more equitable way.

Current (& Future) Pensioners: Other Changes

(Recommendations 24 & 27)

Calculation of Pensionable Income for Persons in the Transitional Group (born 1952 to 1961)

•Change from the best 3 years of the last 11, 12 or 13 years for employed persons and the best 10 years of the last 11, 12 or 13 years (depending when born) for self employed persons to the best 3 years (10 years for self-employed) **in the last 15 years.**

Service Pension

•Pensions Strategy Group recommends that Government should continue with its current policy with regard to phasing out of the service pension for abatement purposes by **committing itself to ignore an additional €200 annually** from the original amount of the service pension abated from the social security pension through fiscal budgetary measures.

Future Pensioners: Contributions

(Recommendations 1, 3 & 4)

- The Group recommends that the **NI rate shall not be increased**.
- The Group recommends that the MCESD discusses **removing the maximum age (65 years) on NI contributions** such that an individual can continue to accumulate entitlements beyond 65.
- The Group also believes that the current practise of ignoring **contributions made between ages 16 to 17/18** is unfair to those who enter the labour market or a trade apprenticeship at that age. The Group is thus of the opinion that as from 1st January 2016 these contributions **should be considered valid for pension purposes for those born before 1962.**
- The Group also recommends that **the minimum number of paid contributions required to qualify for a pension should be gradually raised from 10 to 12 years**.

Future Pensioners: Default Retirement Age

(Recommendation 8)

- The Group recommends that **the Statutory Retirement Age shall not be increased**.

- The Group further believes that Government should task the Malta Council for Economic and Social Development (MCESD) or the appropriate lead Ministry **to initiate and complete a process that would establish a strategic way forward agreed to unanimously by representatives of employers and employees that would result in the abolishment of mandatory retirement on reaching the Statutory Retirement Age** as a counter measure to Malta's rapid aging demographics and to further strengthen the sustainability of the pension system.

Future Pensioners: Early Retirement

(Recommendation 13 & 17)

- At present individuals born till 1961 need 35 years paid or credited contributions to retire at 61, while for those born later the number of years is increased to 40 years.
- To give a better incentive to those working, the Group recommends **that the number of contributions that need to be paid for one to retire earlier shall be established to be at least 7/8s of the total required –** this shall apply only for those born in 1962 or after.
- The Group believes **Government should reward those who opt to contribute longer than required and retire after 61. These shall have their pension increased by an additional cumulative 2% per annum for every year pension is not claimed between ages 61 to 62, rising by an additional cumulative 4% per annum between ages 63 to 64**.
- The Group also recommends that **Government addresses the anomaly created in 2007 and adjust the age at which the non-contributory pension is awarded – this shall be aligned to the normal statutory retirement age starting from those born in 1956**.

Future Pensioners: Pension Deferral

(Recommendation 14)

- The Pensions Strategy Group recommends that a person who reaches 65 may opt to defer receipt of his/her pension. This deferral **would result in the individual (and eventually their survivor) becoming eligible to a higher pension**.

- The rates at which deferred pensions would be increased **would be actuarially fair**, reflecting the prevailing estimates of life expectancy for the age cohort of the individual deferring the pension.

Future Pensioners: Gradual Adjustments

(Recommendations 10 , 11 & 12)

- Our system as is cannot respond to demographic changes, implying risks to both adequacy and sustainability. Rather than having constant ad-hoc changes, the Group believes that the system should gradually evolve.
- To be inter-generationally fair, **the contributions required to earn a full pension must be in line to the time spent receiving pensions**. Since the retirement age shall not be increased further than 65 years, **current demographic projections indicate for those born between 1965 to 1969, the contributory period should rise from 40 to 41 years**.
- The Group also recommends that in each five yearly strategic review required by law, **for each particular age cohort such changes are announced 15 years in advance**.
- The Group also recommends that **the following Strategic Review report due in 2020 should consider whether it would be necessary to adjust increases in the maximum pension to reflect changes in life expectancy** since those on higher incomes are more likely to be benefitting from higher pensioners for longer periods of time.

Future Pensioners: Contribution Credits (1)

(Recommendation 1)

To support families and to help gender equality, the Group recommends that the child-rearing credits are to be increased as follows:

- **For parents born in 1962 or after, for the first child a credit of 5 years contributions is to be awarded, for the second child a credit of 4 years and for each subsequent child a credit of 3 years. For a disabled child the credit would be of 8 years.**
- **For those born from 1952 to 1961, the Group recommends that the credits would be about half this amount**.
- The Group further feels that the current provision, that the parent is required to have returned to work after the credit period and work for at least the same amount of the credited period, needs to be revisited. **While the requirement to resume work should remain, there should not be any limits as for how long such resumption of employment should run to qualify for these credits**.

Future Pensioners: Credits (2)

(Recommendation 2)

- Given the strategic importance to Malta to continue to invest in human capital development as a vehicle for further economic growth and social development, **the Group recommends that contributions are credited up to a 3 months per year of studies for a first degree, 6 months per month of studied for a post-graduate degree, and 12 months per year of studies for doctoral studies** to help fill any gaps in the contribution requirement for a full pension.

- The Group also recommends that **a life-long education contribution credit of up to 2 years is introduced for people who are over 18** and who undertake studies to further enhance their career prospects. Such credit will also be considered for apprenticeships.

Future Pensioners: Part-Time

(Recommendation 5)

- The Group believes that our pension system is to reflect emerging employment patterns and should be reformed to ensure **that the full contributory entitlement is paid by both a person and an employer in the event that a person works up to a 40 hour week irrespective of the number of employers the person is engaged with as a part-time worker**. This would address issues related to low pensions, poverty and precarious work.

- The Group further recommends that **if the number of hours between all part-time jobs exceeds 40 hours, the excess is refunded to employers using some mechanism, for example a pro rata system**.

Migration and Shadow Economy

(Recommendations 6 & 7)

- The Group believes that **Government needs to design and introduce an immigration policy that targets high and semi-skilled competencies, skills and knowledge** as a measure to address on the one hand population aging and on the other hand to meet labour market challenges arising from such population aging.

- Furthermore, **Government needs to undertake the design of a holistic strategy to tackle the shadow economy through mix of policy measures directed to address the key drivers that elicit such behaviour.** The transition of workers from the shadow to the formal economy increases participation rates and in doing so strengthens the sustainability of the system. It also reduces the 'social protection deficit' that persons in the shadow economy are likely to be exposed as it brings them into the formal economy and hence eligible for contributory pension support; and, thus, improves adequacy.

Future Pensioners: Review of NDC

(Recommendation 9)

- To make the system resilient to future changes and make it fair across generations, we need to ensure that the amount one gets from the system cannot grow grossly out of line with what one has contributed.
- An option, used in countries like Sweden and Italy, is introducing a notional defined contribution scheme (NDC) where benefits depend on contributions made and on life expectancy at retirement.
- After modelling work with the World Bank, the Group has concluded that **the system would be difficult to administer and in presence of a relatively generous Guaranteed National Minimum Pension does not create the right incentives**. Cost savings would start around 2040 and would reach 2% of GDP by 2060. This would be at the cost of 90% of new retirees ending on the GNMP.

Further Reform Considerations

(Recommendations 18, 19, 20, & 21)

- The Group welcomes the incentives offered for personal retirement schemes (Third-Pillar), but recommends that **the 2020 Strategic Review should evaluate progress of scheme and consider ways of nudging people to save for their retirement**.
- **Government should consider ways to help the elderly turn their property into retirement income, by formalising equity release and studying setting up a Home Equity Bank**.
- The Group also stresses the **need to inculcate a culture of literacy with regard to financial savings and investments and retirement income planning**, through changes in the national curriculum, use social media, plug gaps in advice services and the **reconstitution the Commission for Financial Literacy and Retirement Income**.

Final Important Consideration

- **The recommendations put forward are designed as a composite whole.** Any single recommendation taken on its own will not result in the desired impacts to the strengthening of adequacy and sustainability of the pension system that the Group has sought to address.

Thank you