STRENGTHENING THE PENSION SYSTEM

A strategy for an adequate and sustainable Maltese pension system

Pensions Strategy Group
17th June 2015

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Impacted Groups

The 2007 Pension Reform has established three different cohorts of persons:

- Exempt Group: those born before 1952
- Transitional Group: those born between 1952 and 1961
- Switchers Group: those born in 1962 or after

References in this Abridged Report and in the Main Report to Exempt, Transitional, and Switchers Groups are to be understood as indicated above.

The new changes being recommended retain, as much as possible, the same approach, with those born before 1962 not much affecred and a gradual change for those born in later years.

Foreword

Two years ago, almost to the date, I was tasked by Government to chair a group of experts with the aim of drawing up a comprehensive strategy aimed at addressing current and future challenges of our pension system.

In a scenario where the pension age is gradually rising by 4 years for males and 5 years for females and there is little desire for further rises, where most social partners are set against increases in pension contributions, and where indicators show that a significant proportion of current pensioners are living at risk of poverty, it was a difficult task indeed.

In a state of play were significant changes have already been made to the pension system, introducing further difficult changes requires not only systemic, institutional and parametric changes but also education resulting in behavioural and cultural change.

Within this context, the Pensions Strategy Group had to design further reforms to the pension system directed to secure adequacy, sustainability and solidarity over the long term. In crafting such reforms the Group has sought to introduce a milieu that incentivises people to change their behaviour as against opting for mandatory mechanisms.

Moreover, the Group has sought to balance adequacy and sustainability without recommending changes to the mandatory retirement age or social security contribution rate. It has sought to weave this balance to minimise, to the extent possible, impacts on disposable income and competiveness.

The Group emphasises that studies and projections indicate quite clearly that our pension system remains solidly sustainable till almost 2040 but beyond that point, if no further changes are carried out, our system would start facing severe sustainability pressures.

The Group has, after assessing the current state of play and what the situation is projected to be in the long-term with no further structural or parametric changes, set out to establish the principles on which it felt the foundations of our pension system should be based in the years to come. These principles are:

(i) the need for a clear definition of the objectives of the pension system;

(ii) an adequate and sustainable pension system sustained by a strong active employment policy;

(iii) the State pension should be a solid foundation, but not the only source of retirement income;

(iv) the pension system to be socially sustainable needs to provide a fair balance between contributions and benefits across generations; and,

(v) to remain adequate and sustainable, the pension system needs to be able to evolve, particularly to respond to long term developments.

Guided by these clear principles, the Group thought about reforms that:

(a) address changing needs and issues relating to society and the labour market;

(b) ensure a socially adequate and sustainable pension system that provides for a fair balance between contributions and benefits across generations;

(c) could be made outside of the pension system to ensure that it is not the only source of income; and

(d) address challenges faced by current pensioners.

There is no denying the fact that, for our pension system to remain sustainable in the long-term, persons due to retire beyond 2030 have to contribute relatively more than those who would have retired before them. This reflects the fact that they will be drawing their pensions for longer. At the same time, our pension system would face adequacy issues if we are not careful with the reforms we put forward aimed at addressing its sustainability.

In such a context, the Group strongly believes that it is recommending financially viable, socially just, innovative and employment-friendly reform measures that seek to address both the envisaged long-term sustainability pressures of our pension system as well as its current and future adequacy needs.

Mark Musu'
Chairperson
Pensions Strategy Group

The Pensions Strategy Group

Mr Mark Musù Dip P.A., C.I.M.C.

Joined the Public Service in 1986, holding various positions within the Ministry for the Family and Social Solidarity and Department of Social Security ever since. He occupied various positions within this department until in December 2005 he was appointed Director responsible for EU & International Affairs within the Ministry for the Family and Social Solidarity. In November 2008, Mr. Musù was appointed Director (Strategic Development and International Relations) in the Department of Social Security and in November 2012 was appointed Director (Pensions Strategy). In March 2013, he was appointed Permanent Secretary within the Ministry for the Family and Social Solidarity, a position he currently holds.

Mr David Spiteri Gingell BA (Hons) Publ Admin, MPA (L'pool), MOTM

Tasked in 2004 to lead pensions reform in Malta - a role he continued to carry out till 2012. In 2013, the new administration invited David to be a member of the Pension Strategy Group and lead its secretariat. David has held senior positions in both the public and private sectors and has worked as an e-Government expert with the Commonwealth Secretariat since 2008.

Dr Aaron G. Grech BCom (Hons) Econ (Melit), MSc (UCL), PhD (LSE)

A Visiting Research Fellow at the London School of Economics, Head of the Modelling and Research Department of the Central Bank of Malta and Deputy Chairman of the Malta Statistics Authority. He conducted his doctoral studies on pension reform under Sir John Hills, member of the UK's Pension Commission, and Professor Nicholas Barr, advisor on pension matters to the World Bank and the governments of Chile, Finland, Sweden, China and South Africa. Dr Grech was an economic advisor on pensions to the UK government for seven years, playing a role in two pension reforms, and also gave technical assitance to the European Commission, the OECD and the Federal Court of Auditors of Brazil. He has published a number of academic articles and contributed to books on pension policy, and presented his work at several international conferences.

Mr Godwin Mifsud B.Com (Hons) Econ, MSc (Econ) (Essex), MA (Pub Pol)

Joined the Public Service in 2001 and has served as Director responsible for Structural Economic Research at the Economic Policy Department within the Ministry for Finance since 2011. He is Malta's delegate on the Economic Policy Committee (EPC) and prior to that he was a member of the EPC Ageing Working Group, contributing directly to its keynote publication, the Ageing Report. Over the years, Mr Mifsud has provided technical input to the pension reform process to the Maltese Government in his official position. He is also a visiting assistant lecturer at the University of Malta.

Mr Edward Buttigieg DPA

Joined the Social Security Department in 1986 and currently holds the post of Director responsible for the operations of all the Contributory Pensions and short-term Benefits administered by the Department under the Social Security Act (Cap. 318). Mr. Buttigieg is a member of the SPC AGE working group on Pensions Adequacy and also a member of the Pensions Forum on Supplementary Pensions issues.

Dr Maja Miljanic Brinkworth PhD.

Obtained her B.A. degree in economics, M.Sc. in statistics and Ph.D. in demography. She specialised in Population and Development at the Institute of Social Studies in the Hague, the Netherlands. She works as a research consultant at the Ministry for the Family and Social Solidarity and lectures at the University of Malta.

Mr. Etienne Caruana B.Sc.

Director of the Social Statistics Directorate within the National Statistics Office (NSO), a post he has held since 2009. Responsible for four units, Mr. Caruana oversees the production of national statistics related to Culture, demography, education, information & communications technology, labour market, living conditions and tourism.

Mr. Alfred Camilleri BA(Hons) Public Administration; M.Sc (Econ).

Joined the Public Service in 1977 is currently the Permanent Secretary at the Ministry for Finance. In the past he served as Director of the Central Statistics Office and later Director General of the National Statistics Office until his appointment as Permanent Secretary in 2006. He has and is still serving in various policy-making positions both locally and abroad.

Mr. Joe Camilleri DPA, MBA (Henley)

Joined the Public Service in 1977. He occupied various positions within the Department of Social Security until in 2004 he was appointed Director (Corporate Services) in the Ministry for the Family and Social Solidarity. A few months after he was appointed Director (Social Security) and eventually Director General (Social Security) in 2007. In 2013 he was appointed Permanent Secretary in the Ministry for Social Dialogue, Consumer Affairs and Civil Liberties.

Mr. Jack Calamatta

Active in trade unionism with the General Workers Union since 1956. He was elected Deputy General Secretary of the General Workers Union in 1985, and in 1996 assumed the responsibilities of Secretary General until he reached retiring age. His long career in trade unionism included active involvement in the affairs of the European Trade Union Confederation, the International Confederation of Free Trade Unions and the International Labour Organization, on whose Governing Body he was the first and only Maltese Trade Unionist to be elected. He was awarded the medal of the National Order of Merit during the Investiture Ceremony at Palace Valletta on 13th December 2001.

01 INTRODUCTION

The Ministry for the Family and Social Solidarity in June 2013 set up a Pensions Strategy Group under the chair of the Permanent Secretary of the said Ministry. The Strategy Group was tasked to submit recommendations with regard to the strengthening of the pension system. A notable departure from previous reforms was that the Terms of Reference specified that the Strategy Group should review recommendations for reform presented by associations representing current pensioners.

The Strategy Group was a multi-disciplinary team constituted of technical persons within the government as well as persons external to it. Continuity with the 2004 and 2010 pension reforms was maintained, as members, including the chair, of these working groups were invited to join the Strategy Group.

02 AN ASSESSMENT OF THE STATE OF PLAY AND THE 2014 NO REFORM BASELINE MODEL

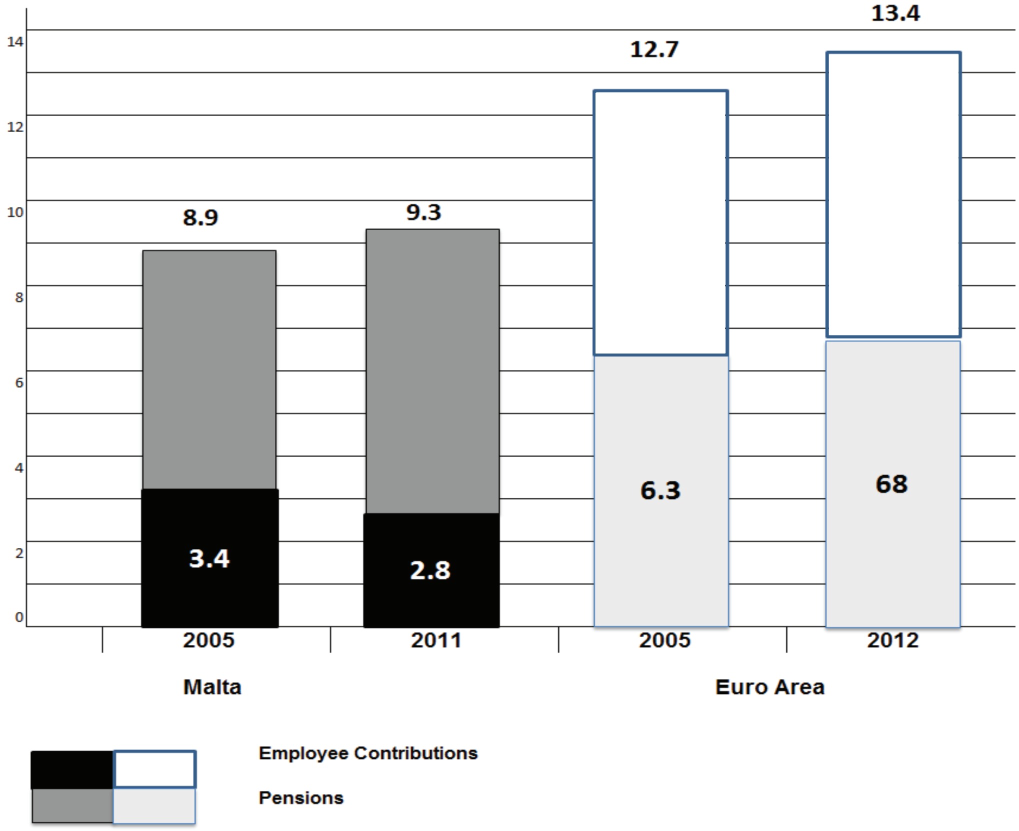
02.1 Assessment of the Pension System in Malta

Given that its Terms of Reference also covered current pensioners, the Strategy Group did not just assess the future state of the pension system, but also reviewed the current situation.

Looking at adequacy, the proportion of 65+ year olds in relative poverty and/or social exclusion fell by 6.3 percentage points, in Malta, between 2005 and 2013. This, however, remains significantly higher by nearly five percentage points (p.p.) than the state of play in the Euro area. Additionally, the Median Pension as a percentage of the Median Wage averaged 47% in Malta between 2012 and 2013, as against 52% in the Euro area.

As can be seen from the Figure below, whilst the spend as a percentage of GDP in Malta increased by 0.4% between 2005 and 2011 the percentage of contributions paid by employees during the same period fell by 0.6%. This is in contrast to what occurred in the Euro area during the same period. Whilst the pension spend as a percentage of GDP increased by 0.7%, during the same period, employee contributions increased by 0.5% - albeit at a lower rate than the increase in GDP spend.

Figure 01: % of GDP Expenditure on Pensions and Paid in Contributions by Employees



The sustainability of the pension system is dependent on the number of persons contributing vis-à-vis the number of beneficiaries in receipt of a pension. A stronger rate of labour market participation results in a more sustainable pension system.

The number of contributors as at the end of 2012 stood at 167,921. This is an increase on the 2009 figures, the baseline of the 2010 Strategy Review, where the number of contributors stood at 159,000. The increase between 2009 and 2012 is of 8,921 contributors; or 5.6%.

The gender mix over this period has changed considerably. In 2009 men stood at 74% and women at 26% of the contributors' population. In 2012 this has shifted to 61.3% men and 38.7% women. This is consistent with the trends in the labour market where in the past years women workers constituted the overwhelming majority of entrants – though as expected, the number of women contributors in the age cohort 40 to 44 years and above remained relatively low in light of the caring role played by women in the Maltese society.

The contributors in the 18 to 24 years cohort is relatively lower than that in the 25-29 years age cohort. This is explained by high increases experienced in the past decade with regard to students following higher and further education. Of particular note is that the number of women contributors in these respective cohorts is marginally lower than that of male contributors.

The number of men contributors in the 45-49 years age cohort dips by over 10% when compared to the 50 to 54 years cohort (11,344) and the 40 to 44 years cohort (11,251) respectively. This may reflect the high migration that took place during the early to mid-sixties when a considerable number of Maltese emigrated to Australia, Canada, United States and the United Kingdom – a period that coincided with considerable economic uncertainty and the rundown of the military services in Malta.

The number of persons in receipt of a contributory retirement pension increased from 37,166 to 56,220 persons between 2004 and 2013 – an increase of 19,054 persons or an increase of 51.3% on 2004. This increase stems from the fact that during this period the 'baby boomers' started to retire.

The proportion of men to women with regard to the retirement pension remained unchanged between 2004 and 2013: 25.6%. This trend more or less is expected to remain unchanged in the coming years given that the number of women who are in the late 40s and over, traditionally worked for short periods, if at all, and assumed full time family responsibilities on marriage and child birth.

The number of persons on a survivor pension, 99.0% of whom are women, experienced a relatively small increase – 2,059 persons for the period under review or an increase of 14.5% on 2014. This number is expected to evolve over time in reflection of developments in the life expectancy of women as well as trends in their respective contributory period.

The average wage increased by 37.2% on 2004 or €4,312 between 2004 and 2013 - from €11,082 to €15,394. The retirement pension increased from €5,418 to €7,288 over the said period – an increase of 34.5% on 2004 or €1,870 between 2004 and 2013. Of note is the fact that the average survivors' pension income is quasi equal to the average retirement pension income.

The Table below presents the Average Pension Replacement Rate (APRR) in proportion to the average wage for the period reviewed. The APRR for the retirement pension is nearly equal to that of the SP – in 2013 the former being higher by 2 p.p. only. The APRR of all three pensions fell during the period under review. The APRR fell by 1.4 percentage points on 2004 with regard to the retirement pension; 3.8 percentage points on 2004 with regard to the survivors' pension; and 1.6 percentage points on 2004 with regard to the invalidity pension.

Figure 02: Average Replacement Rate in Proportion to Average Wage.

Pension	Average Pension Income				Average Wage		APRR			
	2004	2007	2010	2013		€	2004	2007	2010	2013
	€	€	€	€			%	%	%	%
Retirement	5,418	6,027	7,107	7,288	2004	1,082	48.9	49.3	49.5	47.5
					2007	12,23				
Survivors	5,462	6,026	6,681	7,011	2010	14,368	49.3	49.3	46.5	45.5
					2013	15,394				
Invalidity	3,754	4,200	4,544	4,972			33.9	34.3	31.6	32.3

The Social Security Contribution 'Fund' in 2004 had a relative surplus of 20.6%. To be noted the State contribution with respect to the Social Security Act is being included under total revenue. This surplus which fell to 3.3% in 2010 marginally rebounded in 2013 to 3.9%. The increase in the surplus balance of the 'Fund' is the result of 2007 reform measures directed to increase the Maximum Pensionable Income (MPI) for the Transitional and Switchers Groups respectively.

Figure 03: State of Account of 'National Insurance Contribution Fund'

		2004	2007	2010	2013
		€000,000	€000,000	€000,000	€000,000
1	Social Security Contributions	295	320	365	432
2	Direct contribution SSA 1987	147	160	183	214
3 = 1+2	**Total Revenue**	**442**	**480**	**547**	**645**
4	Invalidity	36	37	29	25
5	Retirement	201	262	368	410
6	Bonus	26	29	47	59
7	Widows	77	90	102	114
8	Short Term	10	10	11	12
9	**Total Contributory Benefits**	**351**	**429**	**529**	**620**
10 = 3-9	**Current Balance**	**91**	**52**	**18**	**25**
11 = 10/3	**Relative surplus**	**20.6%**	**10.%**	**3.3%**	**3.9%**

02.2 The 2010 Strategic Review on the Adequacy, Sustainability and Solidarity of the Pension System

The 2010 Strategic Review which was tabled at the House of Representatives in December 2010 had presented a disquieting picture. The projections, carried out on the World Bank Pensions Reform Options Simulation Tool kit (PROST), and based on the EUROPOP 2008 demographic projections and the Ageing Working Group 2009 macro-economic projections, showed that by 2060 the average pension replacement rate (APRR), that is the average level of adequacy, when compared to the average wage, would fall to 45%; (- 9.6% lower than that enjoyed by pensioners at the time of the review) – which at the time stood at 54.7%.

The state of the pension system was seen to be in equilibrium until 2035 but, thereafter deteriorating rapidly as pension spending was anticipated to rise to 15.3% of GDP in 2060, up by 6 p.p from its 2013 level.

To address the state of play in an incremental and flexible manner, the 2010 Strategic Review presented a comprehensive range of recommendations to strengthen the pension system - recommendations spanning demographic and labour market policies; changes to the First Pension and the establishment of a Second Pension and Third Pension pillar respectively.

The core recommendation of the 2010 Strategic Review, was undoubtedly the recommendation proposing the grafting of a longevity/retirement index on the First Pension and in the event that this recommendation was rejected, the undertaking of an in-depth study to assess the possibility of moving onto a Notional Defined Contribution (NDC) pension architecture.

The Strategic Review further proposed that government should by not later than 2020 introduce a mandatory Second Pension on the basis of bi-partisan agreement. Of the 44 recommendations proposed by the 2010 Strategic Review this was the most controversial. Be that as it may, almost none of the recommendations put forward were taken on board and implemented.

02.3 The 2014 Baseline No Reform Model

The modelling carried out by the Strategy Group, which like that of the previous review uses the PROST model, EUROPOP and EPC Ageing Working Group assumptions, presents on a No Reform Basis, an observable improved situation when compared with that of the 2010 Review.

What has, therefore, changed in this short period? Both the latest releases of the EUROPOP and Ageing Working Group assumptions present a more positive scenario than their previous releases on which the Strategic Review was based. For example, EUROPOP 2013 assumes that by 2060 Malta's population will increase to 476,982 - unlike EUROPOP 2008 which projected that the population would decrease to 408,000. Similarly the Ageing Working Group 2015 macro-economic assumptions assume a participation rate in 2060 for persons 15-64 years of 75.4% as against 70.3% in the previous set of assumptions.

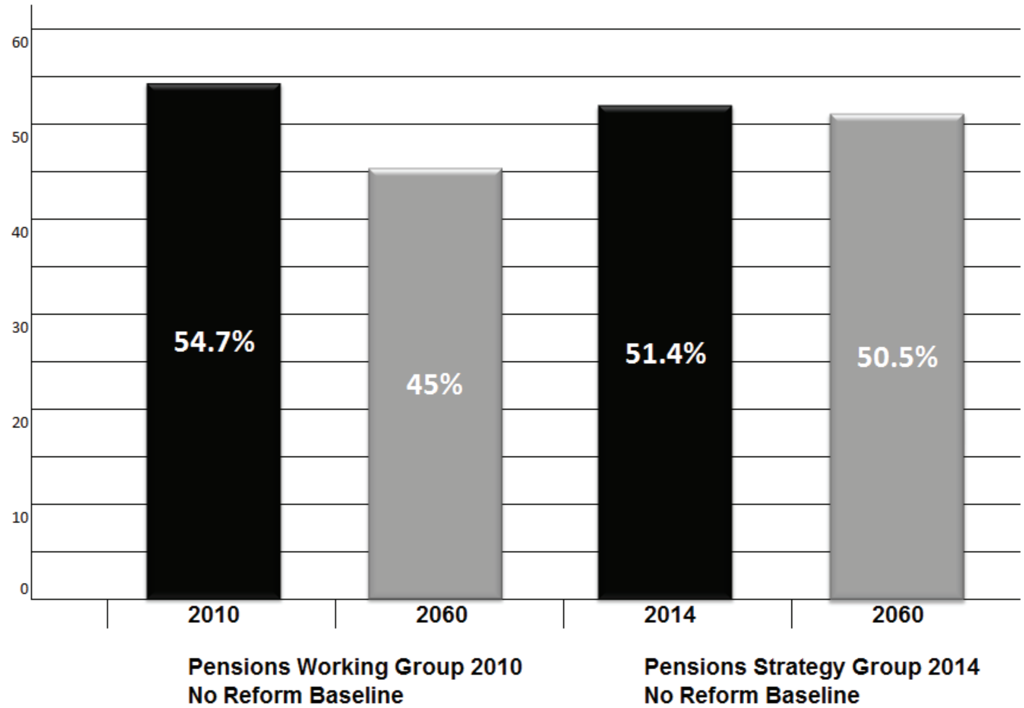
Figure 04: Baseline No Reform Model Assumptions

	2004 PWG	2010 PWG	2014 PSG
Base Year	2050	2060	2060
Population	388,000	408,000	476,682
Fertility Rate	2.1	1.48	1.78
Life Expectancy Gains	M 5.1, F 4.2	M 8.3, F 7.5	M 6.4, F 6.3
Net Migration	Constant 650 per year	960 in 2007 falling to 880 in 2060	1,617 in 2013 falling to 1,146 in 2060
Participation Rates: 15-64	63.1	64.5	75.4
Employment Rates: 15-64	64.1	64.4	70.3
GDP	3.5% average constant 2005-2025; 2.5 average constant 2026 and 2050	1.75% average constant	1.7% average constant
Labour Productivity Rate	3.25%	1.75%	1.5%
Treatment of Government's Share of NI Contribution	Excluded	Included	Included

Thus, on the basis of these latest assumptions, in 2060 the pension system on a No Reform Basis should result in an APRR of 51.7%, an improvement of 6.7 p.p. relative to the baseline in the 2010 report.

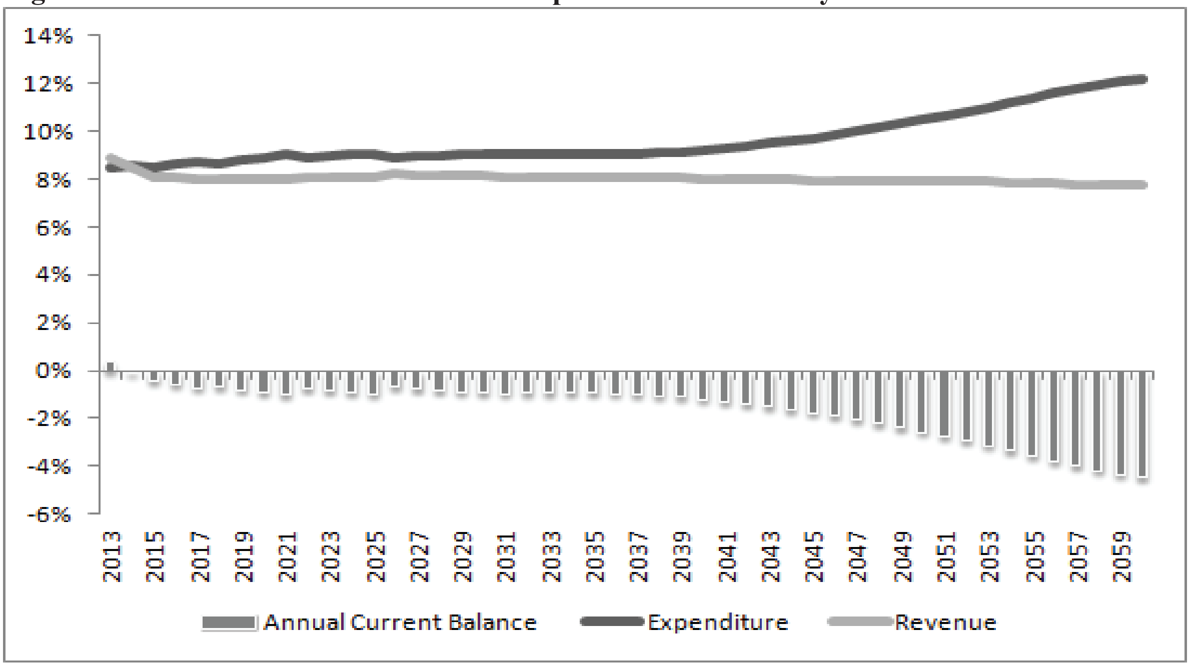
Whilst this Report is reporting a relative improvement relative to the 2010 Review, it is to be underscored that the core financial fundamentals of the pension system with particular regard to the sustainability of the said system do not change and confirm the challenges to the sustainability of the pension system especially post-2040. The projections, which cover contributory pensions for retirement, survivorship and invalidity, are based on data for 2013. In 2013, Government expenditure on these categories of benefits stood at €609.2 million. During the same year, revenues relative to Social Security Contributions amounted to €645.3 million, around a third of which reflect the State Contribution under the obligations of the Social Security Act.

Figure 05: Baseline No Reform Model - Impact on the Average Pension Replacement Rate (Adequacy)



As illustrated in the Figure below, the ratio of total revenue as a proportion of GDP is projected to decline marginally over the projection period from 9% of GDP in 2013 to 7.7% of GDP by 2060. This contrasts with the projected trends for expenditure which is expected to remain broadly stable by around 2040 and then rise to 12.5% of GDP by 2060. This implies a rise of 4.1 p.p. throughout the entire projection period. Consequently, the system balance is projected to worsen from a small positive balance in 2013 (taking into consideration the State contribution), to a deficit of 4.8% of GDP by 2060.

Figure 06: Baseline No Reform Model – Impact on the Pension System Deficit to GDP



The unforeseen rise in generosity relative to the 2010 Report, reflects a much faster increase in minimum and maximum pensions (due to larger increases in wages and higher employment rates), would occur at the height of the ageing transition.

These two developments, the rapid increase in spending post-2040 and the unintended significant increase in generosity after that date, shows that much still needs to be done to the pension system architecture to render it sustainable. It needs to be kept in mind that while the current generosity of pensions can be justified on the grounds that typically pensioner households only have one pension income to share between themselves, by 2060, it is believed, that the bulk of pensioner households will enjoy two individual pensions as it is far likely that both male and female members of a family would have accumulated a qualifying contributory history.

The previous reform package had taken this in account, when it envisioned a decline in average generosity to 45% in 2060.

03 THE PRINCIPLES UNDERPINNING THE PROPOSED REFORM OF THE PENSION SYSTEM

In taking forward further reform to the pension system, and building where appropriate on work done over the past decade, the Strategy Group established five underlying principles to guide its work. These are:

(i) The need for a clear definition of the objectives of the pension system.

(ii) An adequate and sustainable pension system sustained by a strong active employment policy.

(iii) The State pension should be a solid foundation, but not the only source of retirement income.

(iv) The pension system to be socially sustainable needs to provide a fair balance between contributions and benefits across generations.

(v) To remain adequate and sustainable, the pension system needs to be able to evolve, particularly to respond to long term developments.

There is no doubt that the 2007 pension reform was important as it was the first step to address the many challenges and issues that characterised what had become an ossified system that had remained practically unchanged for nearly three decades. As has become ever more evident looking at the experience of other countries, a pension system, however, needs to evolve gradually to reflect the changing economic, demographic and social environment, rather than shifting abruptly in large overhauls. For the pension system to remain relevant and fulfill its objectives within the constraints set by society, it needs to be able to evolve smoothly.

One of the main challenges for policy-makers involved in the reform of a pension system is how to balance short-to-medium term challenges with those of a more long term nature. Most frequently short-to-medium challenges are resolved with short-term fixes, while long term issues are not thought through adequately.

A more common problem is that many times policy-makers adopt very radical changes for the medium to long term while buying political support by giving a better deal for the short to medium term. Such a strategy, while naturally politically attractive, in the long term is self-defeating.

The main issues facing national pension systems are relatively clear and require socially sustainable solutions. Pension systems were set up as inter-generational social contracts which were meant to provide a fair and equitable transfer of resources across generations.

The more one deviates from this principle, the more unlikely it is that these systems will stand the test of time. To remain viable, a pension system needs to be a robust arrangement that can, however, evolve gradually to fit the needs of the society it is meant to serve as it changes over the continuum of time.

In developing these principles, the Strategy Group has sought to learn from the experience of other countries that have reformed their pension systems over the last decades.

0.4 THE REFORMS TO THE PENSION SYSTEM

The recommendations presented by the Strategy Group are framed around the above-mentioned five principles. The recommendations are based on four pillars.

04.1 Addressing Changing Needs and Issues relating to Society and the Labour Market

The robustness of the pension system is dependent on core supporting policies with regard to the strengthening of Malta's demographic base; securing, to the extent possible the highest level of active participation by all cohorts in society; and accounting for the demands of an evolving society.

Most will agree that Malta's employment record since EU accession has been a success story. Whereas in 2000, the employment rate of persons aged 15 to 59 was 8 p.p. less than that in the EU, by 2013 this gap had dropped to just about 1.5 p.p. Malta's employment rate among males in this age group exceeds by far that in Europe. At the same time, the gender gap has steadily been closing such that since 2012 women aged 15 to 39 in Malta have a higher employment rate than those in the EU. Yet challenges remain.

Be that as it may, Malta faces significant challenges. The fertility rate has collapsed. The average age at first birth has increased from 25.8 years in 2000 to 30.6 years in 2014 (all mothers 18 years of age and older at time of first birth). Similarly the average age at time of first birth of mothers who gave birth to at least two children has also increased from 26.6 years in 2000 to 32.4 years in 2014.

In terms of interrupted career patterns, with the start of the ageing transition, Maltese women can be expected to take more time out of the labour market for child rearing and caring duties. The result is that a woman who takes time out of the labour market to care for her family, is likely to receive a lower pension income due to a shorter contribution record, or because she is relegated to the sphere of part-time or informal work.

With the above in mind, the Strategy Group recalibrated the child rearing credits framework introduced in the 2007 reforms by increasing the credits awarded. This is done to achieve three objectives. The first is to compensate for the discrimination the traditional social model places on the woman as a result that giving birth and rearing a child interrupts her career. The second is to encourage a mother to become even more actively engaged in the labour market - an objective which is now strongly supported by the availability of free child care support and the increasing presence of pre and after school facilities. The third is to leverage the pension system to positively impact the tempo and quantum effects of fertility. Moreover the proposed credits give due consideration to the added care requirements of disabled children for their parents.

Malta's ageing population renders it imperative that the country's economic growth is primarily achieved by expanding productivity. The expansion of productivity is achieved not only through technology, innovation and efficiency improvement but also through the competency, skills and knowledge levels of the human capital pool available to the country.

Malta's further economic and social development is, thus, intrinsically tied with the competency, skills and knowledge of its human capital – which demands upgrading and deepening of such competency, skills and knowledge. Recognising that Malta's further economic and social development is intrinsically tied with the competency, skills and knowledge of its human capital and that persons with further and higher education have a higher gross value added, the Strategy Group recommends a framework of crediting of contributions in this regard.

Lifelong learning is a strategic policy instrument for active ageing as it becomes more and more a pre-condition for an economic integration of elderly persons. It is recognised that (i) a highly educational attainment leads to improved labour market integration; and (ii) high educated employees tend to stay longer in the workforce because having, for example, better working conditions result in an expansion of working lives.

The need to strengthen the framework for lifelong learning for persons over 18 years of age to ensure that they gain new and upgrade competencies, skills and knowledge in a fast changing world, is deemed to be of cardinal importance. This results from the fact that persons who exit from the labour market will be in receipt of a lower income based pension than that received by persons who remain in the work force beyond 61 years or the statutory pension retirement age. To strengthen the framework for lifelong learning the Strategy Group recommends a system for the award of credits for persons who follow such accredited programmes.

Additionally whilst Malta should continue to invest in indigenous human capital to ensure that there is a labour supply to meet competencies, skills and knowledge in future growth areas as well as targeting competencies, skills and knowledge gaps where these exist, the Strategy Group recommends that Malta must complement such investment with an Economic Migration Policy.

Furthermore, action should be taken to regularise the status of current immigrants so that these are in a position to positively contribute to Malta's economy. This will not only productively muster the competencies and skills that such persons possess but will eliminate possible abuse where such persons are illegally engaged at a pittance and with no employment rights.

The pension system continues to be strongly geared to the "male-breadwinner model" based on a "standard employment contract" for men; an arrangement essentially characterised by permanent full-time work in the service of one employer. Yet, traditional work practices are changing. This type of arrangement is no longer the sole model of employment – particularly in the knowledge economy sectors which have led, in recent years, to increasingly flexible occupational lives and career paths. In addition, even the traditional family is evolving in light of the rising participation of females in the labour market and the increasing prevalence of looser family arrangements as opposed to the stable nuclear family of the past.

There is an increasing trend where persons with the appropriate competencies, skills and knowledge in such sectors are able to leverage a better return on the investment they made in their education, training and experience gained by undertaking assignment based work – particularly if a particular sector has a competencies, skills and knowledge deficit. This job sharing concept also applies with regards to women who seek compatibility between employment and family life by working on a shared basis.

The pension system does not support atypical employment on the basis of shared employment. A person who is employed part-time (that is not self-employed) in more than one job with different employers (including the different companies but with the same Directors) pays the contribution on the part-time job that has the highest pay in terms of the wage paid.

The impact to a person undertaking such atypical employment, therefore, is significant as his or her pension income is likely to be much lower given the curtailed level of contribution s/he would have paid on the highest wage earned from one part-time job rather than the total income earned through different part-time jobs. The Strategy Group proposes that the necessary reforms are introduced in this regard.

It is to be noted that undeclared work in Malta is still present. With particular regard to pension reform, the facilitation of the transition of workers from the shadow to the formal economy has two strategic imperatives. The first is that it will allow for the creation of more formal jobs so as to enable Malta to increase employment participation rates and to move closer to the goal of full-employment. In doing so, such a transition from the shadow to the formal economy will thus contribute to the strengthening of the sustainability of the pension system. The second is that it reduces the 'social protection deficit' that persons in the shadow economy are likely to be exposed to given that they have little or no access to social security or protection beyond non-contributory benefit support. The transition into the formal economy will mean that such persons will become eligible for contributory pension support and hence assist in securing improved adequacy in retirement.

The tackling of the shadow economy, therefore, requires a mix of policy measures directed to address the key drivers that elicit such shadow behaviour at the first instance which include, but are not limited to, the minimisation of exploitation where it exists, unlicensed use of illegal immigrant labour; education through the improvement of skills and competencies of workers in the shadow economy, to demand based incentive measures, to facilitate the transition from the shadow to the formal economy. The Strategy Group, thus, recommends that the Government establishes a multi-disciplinary team to draw up a holistic strategy directed to tackle the shadow economy in Malta. This would complement ongoing efforts directed towards combating precarious employment conditions in Malta.

04.2 Reforms to the Pension System Directed to ensure a Socially Sustainable System that provides for a Fair Balance between Contributions and Benefits across Generations.

In designing the recommendations, within the framework of these principles, the Strategy Group sought to tilt the pension system from an ossified framework where unforeseen future outcomes lead to significantly different outcomes, to one that evolves gradually, smoothly, and incrementally in the face of constant changes in the economic, demographic, social and political environments. It is quite indicative that in just 4 years, changing demographic and economic projections resulted in a revision downwards of expenditure of 3.1% of GDP and an upward revision in the APRR of 6.7 p.p. To maintain trust in the system, Malta requires a system that is not continuously caught off-balance.

In seeking to achieve this, the Strategy Group did not opt for strict automatic mechanisms being drafted onto the pension system. Rather, the Strategy Group builds on Recommendation 62B of the Social Security Act, the tabling at the House of Representatives of a strategic review every five years on the adequacy, sustainability and solidarity of the pension system, which should be complemented by a bi-partisan technical pension commission.

The latter would every five years effect changes to the pension architecture on certain parameters with changes affecting successive generations announced 15 years in advance to enable such persons to make appropriate adjustments. This would enable the commission to regularly assess the relationship between the derived benefits and contributions for each generation.

In this respect, the Strategy Group does not recommend fundamental structural changes in the pension system. Together with the World Bank, the Strategy Group studied whether Malta should migrate to a Notional Defined Contribution (NDC) pension architecture. The Strategy Group concluded that the presence of the strong Guaranteed National Minimum Pension (GNMP) renders it unlikely that a NDC architecture would deliver satisfactory results in terms of enhancing pension adequacy and sustainability. It is, thus, seen to be risky to undertake such a complex systemic change for marginal benefits at best.

An underpinning principle of the pension system is that it is based on a PAYG inter-generational contract between successive generations. Each generation of workers contributes towards paying the benefits due to the previous generation of workers on the understanding that a future generation will do the same in its regard. This concept of social solidarity is one of the main strengths of the pension system and needs to be maintained.

Demographic changes, however, are bringing about fundamental changes in the terms of this social contract. On the one hand, people are living for longer, and thus drawing pensions for a much longer period of time. This creates additional pressures on current contributors. On the other hand, the size of contributing generations, after decades of steady growth, is projected to start declining. This is expected to add further pressures on future generations of contributors, to make good for their part of the social contract.

These demographic changes mean that the terms of the social contract are being rewritten in a way that threatens adequacy and sustainability. Current generations of men are retiring at 61 and can expect, on average, to receive a pension for 21 years, while women (due to their longer life expectancy) can expect to draw their benefit for close to 26 years. Persons in the Transitional Group (born from 1952 to 1961) to draw a full pension, they are required to have contributed 35 years including the last 10 years before retirement, while those in the Switchers Group (born after 1961) require 40 years .

If these conditions remain unchanged, by 2060, an individual in the Switchers' Group will be able to retire at age 61 with a full pension, after having contributed 40 years, and then expect to draw this pension for more than 26 years. The ratio between the number of years contributing and those drawing a pension would change from one and two-thirds years contributing for every year drawing a pension, to one and one-third years contributing for every year drawing a pension. This would happen at a time when a relatively smaller cohort of contributors will be present to finance this transfer.

The Strategy Group is of the considered opinion that reforms are introduced that would ensure that the inter-generational social contract, to remain equitable in the face of changing circumstances, the ratio between the number of years contributing to those drawing a pension needs to be maintained stable. Individuals will still be able to leave the labour market at the same age as before, but to qualify for a full pension their contributions need to evolve in line in line with the length of the period during which they would be drawing a full pension.

To allow individuals to make the right choices, the Strategy Group believes that the required contribution period to receive a full pension would be set by a special body every five years and announced fifteen years in advance. The implementation of the measure with regard to the tightening of the contribution period with a person's working life should be gradual.

The Strategy Group recommends that the first tightening between the contribution period and a person's working life should be introduced with effect from 1st January 2016. This will affect those persons who today are aged between 50 and 46 years of age (born between 1965 and 1969). The contributory period for this cohort of persons will increase from 40 to 41 years.

The Strategy Group does not agree with the philosophy that persons who exit at 61 years of age, once they meet the 35 (Transitional Group) / 40 (Switchers Group) contributory history are penalised through a reduction in the pension income for each year that they retire before 65 years of age.

There is a large body of empirical evidence that shows that financial incentives embedded in pension systems influence people's retirement behaviour. Many OECD countries have undertaken reforms in recent years to make early retirement less attractive and to encourage people to work longer by offering higher pensions to people who retire later.

The Strategy Group underlines that an approach to secure a balance with regard to the retirement age of manual workers and non-manual workers through a pension system that incentivises rather than penalises persons to continue to remain active in the labour market is its preferred approach. Be that as it may, the Strategy Group acknowledges that a degree of social cost should be borne by the person who opts for leisure once s/he meets the above-mentioned criteria and exits the labour market. This social cost would be based on the principle that the rate of incentive to which a person who retires before 65 years of age would not be actuarially fair.

Furthermore, the Strategy Group is not in agreement with a reform resulting in the introduction of an indexation mechanism that links the statutory pensions retirement age with longevity as recommended by the 2010 PWG. Many OECD countries have undertaken alternative reforms in recent years to make early retirement less attractive and to encourage working longer by offering higher pensions to people who retire later.

The Strategy Group prefers a policy approach that incentivises individuals to opt for later retirement once they reach the statutory retirement age, by offering them the chance to contribute more so that they qualify for a full pension, or if they already qualify for one offers them the chance to get an increased pension by deferring their claim.

The Pensions Group is proposing an adjustment rate incentive that would be accrued to the pension income in the event that a person defers his or her take up of his or her pension by opting for a late retirement. It is being proposed that a person who can retire early at age 61 but decides to continue working without claiming pension could top up his pension income by up to 12% (if he continues to work up to 65 years). Furthermore if a person decides to opt for a late pension past 65 years of age would benefit from a top-up of 5.3% (actuarially based) on the pension incomefor each year he or she remains active and defers claiming pension.

The decision to opt for a late retirement would not just improve the individual's pension, but also the pension entitlement of their spouse when they decease. This flexible and positive approach is seen to have a far more pervasive and equitable impact than one that mandates an individual to remain in the labour market on the basis of longevity, irrespective of their state of health, the type of profession, skill or trade they possess, or their individual preferences.

In the context of the above, the current ceiling of 65 years on the payment of contributions by employers and employees is an obstacle to encouraging and incentivising more active participation of elderly persons (with no consequential improvement in their pension entitlement) and it is being recommended that discussions take place within MCESD and MEUSAC, with a view to possibly remove this ceiling and that the individual and the employer will pay contributions as long as that individual remains active in the labour market.

Furthermore, the Pensions Strategy Group understands that there cannot be an abrupt transition from a pension system – and labour market – that is governed by a Statutory Pensions Retirement Age which is also the Mandatory Retirement Age to one that abolishes the Mandatory Retirement Age criterion on age equality based legislation. The Pensions Strategy Group underlines that such a debate cannot be ignored and recommends a process of discussion under the tutelage of the Malta Council for Economic and Social Development with the aim of leading to a possible abolition of the Mandatory Retirement Age.

The 2007 reform introduced the concept of the Guaranteed National Minimum Pension. The Social Security Act in Section 50A defines the GNMP to be "payable at such a rate being not less than sixty percent of the National Median Income as the Minister may, with the concurrence of the Minister responsible for finance, by order under this article from time to time establish and in any case such Guaranteed National Minimum Pension shall not be less than that established for the preceding year".

At the time this amendment was made to the Social Security Act the Government had as yet to determine which yardstick to adopt to determine and benchmark the 'National Median Income'. In this light, the Strategy Group argues strongly that the parameters governing the value of the GNMP need to be specified clearly and in a way that allows it to evolve gradually upwards while maintaining positive incentives for individuals to contribute to the pension system.

The Strategy 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.

Moreover the Strategy Group proposes that the GNMP should be set at the poverty threshold level available in 2016 (2016 is the proposed point of entry of the gradual phasing in of GNMP for all in line with current Government's Electoral Manifesto proposal). Thereafter the GNMP increases by the full COLA for that year plus any difference between the full COLA and the income level resulting from the application of an indexation of 50% wages and 50% inflation. This means that the increase on the GNMP through the application of the full COLA would constitute the minimum increase.

This will secure that (i) the initial level of the GNMP is set at a level consistent with a poverty alleviating income level; (ii) as a minimum, the GNMP will increase from year to year on the basis of the full COLA; thereby ensuring that its purchasing value of the GNMP is protected over time; (iii) the GNMP reflects growth in wage levels, through the indexation formula, and maintains the relativity with the maximum pension which is being proposed to be indexed in the same way; (iv) will ensure equity amongst pensioners with relatively lower incomes as persons will receive the same level of pension value irrespective of the year they retire.

The Strategy Group is cognisant of the fact that over the time the relative poverty threshold may grow at a different rate than the proposed indexation. To ensure, therefore, that the GNMP remains, over time, adequate and sustainable, the five year strategic review mandated by the Social Security Act will be tasked to present recommendations on whether its level would need to be adjusted.

As a further a measure to combat poverty and social exclusion, the Pensions Strategy Group is of the considered opinion that the Old Age Pension be directly linked to the National Minimum Wage so that any increases to the latter would automatically result in increases to the Old Age Pension. This would result in an immediate increase to non-contributory old-age pensioners.

In addition, the 2007 reform, as well as the 2010 Strategic Review, gave no consideration to the importance of ensuring that the retirement age should not only be consistent across gender but also across different forms of retirement pensions: non-contributory as well as contributory. Thus, whilst the statutory retirement age gradually started to increase from 60 years for women and 61 years for men to 65 years, there was no similar recommendation to lift the qualifying age for the Old Age Pension on the same grounds. This was an oversight given that the focus at the time was narrowly directed towards the contributory retirement pension.

The Strategy Group considers the retirement age of 60 years of age for the Old Age Pension as a potential 'formalised' exit route from the labour market for persons with no or little wealth and who thus would satisfy the qualifying means-test. The Strategy Group, thus, recommends that this is brought in line with the contributory statutory retirement age.

04.3 Reforms outside of the Pension System to ensure that it is not the Only Source of Income

The Strategy Group supports the design of the personal retirement schemes as tabled in the House of Representatives. The decision to adopt the initial level of pension contribution allowance is based on the forecasts made by the 2010 Pensions Working Group which projected that the APRR will decline from 54.7% to 45% in 2060, with the voluntary pension generating a replacement rate of 9.7% to keep average generosity unchanged.

This Third pension scheme is an incentivised 'voluntary scheme'. Traditional economic theory underlines that a person acts rationally, where-in throughout his or her lifecycle s/he borrows when young, save in middle age and builds wealth and spends his or her savings in old age. In truth, a person does not act rationally when s/he comes to plan long term.

Behavioural science suggests that people cannot plan rationally over their lifetime, so instead display biases and use judgements based on rules of thumb or social and cultural norms. Behavioural science recognises that people use heuristics, or mental short cuts and biases, to help them make behavioural choices. Research suggests that, in the main, people are left by themselves to provide for retirement, empirical evidence shows that some of them will not save enough for retirement.

In order to reduce these barriers, in order to get people to save enough for an adequate retirement income, a number of governments have introduced mandatory opt-in voluntary opt-out, or automatic enrolment schemes. Such schemes are directed to capture young people in the labour market automatically and hence countering behaviour limiting issues such as myopia or inertia.

By automatically capturing young people early, it is believed that they are more likely to remain within the pension scheme, given that they will structure such investment as part of their long term savings profile, before they assume long term expenditures resulting from a decision to raise a family or other responsibilities. Automatic enrolment is, therefore, intended to work by turning on its head the inertia that inhibits saving. Automatic enrolment will overcome people having to make a proactive decision today about their future, as they are automatically saving for a private pension - unless they decide to opt out.

The Group recommends that the 2020 Strategic Review should carry out an in-depth review of the Third pension schemes introduced. In the event that the Review shows that the Supporting Retirement Savings scheme would not have delivered as originally planned, the Review should give strategic consideration to recommending a Mandatory Opt-In Voluntary Opt Out Scheme, where the employer is responsible for managing the administration aspects of the scheme, and the government is responsible for the design of the fiscal incentive framework of the scheme.

76.4% of persons in Malta own freehold and ground rent of their home. For the majority of people, buying a home is the single largest investment made in their lifetime. By the time they reach retirement age they would have paid most of the borrowing they used to purchase their home. In owning their home, as they near retirement, persons would have built up considerable amount of equity in their home. The value of the property would constitute a high proportion of accumulated wealth of most elderly persons. Consequently, the high level of property ownership in Malta means that most persons are asset rich but cash poor.

Today, there is no formal home equity market in Malta that is governed and regulated. Yet, there are people who do release value from their property as they retire. Some persons will downsize by selling their home and move into a smaller house. Others enter into arrangements with private providers of residential homes for the elderly in exchange of their property. Yet many others may have homes worth significant equity but limited savings with the State pension acting as the main source of income during retirement.

Both the 2004 and 2010 Pensions Working Groups respectively recommended that the appropriate competent authorities should introduce a regulatory framework for equity release schemes. The Strategy Group agrees with the recommendations presented in this regard. Despite the resistance to consider this option, the fact is that there are people who, today, enter into arrangements with private providers of residential homes for the elderly in exchange of their property. They do this, and will continue to do so, because as said before most elderly families are asset rich but cash poor.

To kick-start the process formalising the home equity market, the Strategy Group proposes that Government should conduct a study to determine the size of the informal home equity market, and carry out a study of the possible take-up of more formal arrangements. The Group further recommends that the Government should consider studying the possibility of setting up a Home Equity Bank, financed either through European Union funds or borrowing from multilateral institutions, such as the European Investment Fund. An alternative approach would be to get funding from the National Development Bank mentioned in the Government's Electoral Manifesto.

As financial market instruments have become more sophisticated, people are more likely to make errors when choosing and using financial products, and can suffer considerable losses as a result. Additionally, most persons do not truly understand the pension social contract and overestimate the pension income they will receive on retirement.

Thus, education on financial literacy and retirement income is needed to equip persons with competencies and knowledge, so that predictable mistakes when planning for retirement are minimised. In this regard the Strategy Group urges Government to re-convene the Commission on Financial Literacy and Retirement Income with a mandate to (i) inculcate a culture of saving for retirement; (ii) strengthen financial literacy and knowledge on retirement income; and (iii) disseminate within the polity information on how the State pension works.

04.4 Reforms to address Challenges faced by Current Pensioners

The representatives of current pensioners' organisation argued that the Maximum Pensionable Income parameter established for the Switchers' Group in the 2007 reform is discriminatory with regard to other cohorts of pensioners. The Strategy Group unequivocally disagree with this position. The Switchers Group unlike the other two Groups, Exempt (those born before 1952) and Transitional face the full brunt of the 2007 reform. Inter-generational solidarity must be based on inter-generational equity.

The position presented by the current pensioners' organisations not only has a significant impact on spending as a percentage of GDP, but it also constitutes a benefit for which current pensioners did not contribute and which would be borne by future pensioners. It is, indeed, the latter who are facing a pension system where the relationship between contributions and benefits is considerably tightened and who are facing risk as a result of demographic aging and economic uncertainty that are far more significant than that faced by the current generation of pensioners.

At present, for a significant number of pensioners their benefit is aligned to an annual assessment of existing collective agreements whilst the pension income of all other pensioners is increased by the COLA. The Strategy Group believes this is socially unjust as it provides no protection to workers who are not covered by a Collective Agreement, who tend to be those on the lowest pension.

In this regard it believed that a far more socially equitable solution is that of replacing the current assessment process by an indexation mechanism based on a formula which sees pensions for current pensioners and persons in the Transitional Group increase annually by a % (percentage) of a ratio of 50% Wage Growth : 50% Inflation Growth or the full COLA whichever is the highest.

Another issue concerns the current calculation of the pensionable income of persons within the Transitional Group which is based on the best 3 years of the last 11, 12 and 13 years for employed persons and the best 10 years for self employed persons, depending when born. This is seen to cause a handicap for such persons who may have lost good paying jobs or underwent difficult business cycles in the the last 11 to 13 years. The Pensions Strategy Group recommends that by not later than 2018, the pensionable income for the Transitional Group is calculated by being based on the last 15 years prior to retirement.

A recommendation presented by pensioners' organisatons proposed that a wife should be provided with the full retirement pension upon the death of her spouse. It is pertinent to underline that the PWG 2010 had concluded that the current format of the survivor partnership is gender discriminatory and had recommended that the female survivor should be provided the full retirement pension upon the death of her spouse.

There is no doubt that the proposal presented by the pensioners' organisatons has merit, and in an ideal world should be adopted. The concern with this recommendation is the cost it will add to the annual pension expenditure. Projections carried out by the Strategy Group show that if this recommendation was to be adopted it would result in a substantial annual increase in the pension expenditure.

The Strategy Group recognises that traditional employment patterns are changing and that the pension system must respond to such changes.

Yet, as the number of women who are active in the labour market is on the increase and will continue to do so. This means that women will have a pension of their own as a result of their employment contributory history. As society continues to change and evolve the purpose of a survivors pension as a 'derived' right will be increasingly questioned.

To account for the fact that a woman who is active in the labour market is contributing to the economy's and her family's well being, the Strategy Group recommends that the surviving spouse will get the deceased spouse's full pension as opposed to the 5/6th successor's pension to which she is entitled today. This is subject to the condition that the surviving spouse has or would have a right to a pension in her own right. In the eventuality that the latter is higher, then she would continue to receive the latter.

The Strategy Group also is recommending that the contributions made before the age of 18, which are currently disregarded in pension entitlements, be taken into account for persons born before 1962. A significant number of women who contributed at these ages and then left employment after having their first child are being negatively affected by this. Similarly manual workers who are less able to lengthen their career in response to the changes in the contributory period made in the reform of 2007.

Finally, whilst various recommendations were proposed by representatives of current pensioners' organisation over the past years to find a solution to the service pension issue, the Strategy Group is of the considered opinion that this constitutes a 'sui generis' issue. The issue is a direct consequence of the introduction of the Social Security Act in 1979. The principal stumbling block, however, has and continues to be the question of the fiscal implications involved although, with very few exceptions, all service pensioners have not contributed towards their service pension. Moreover, when adding both their service pension and their social security pension, service pensioners still get a better deal (in many cases substantially better) than those who have only their social security pension. Nonetheless, the 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.

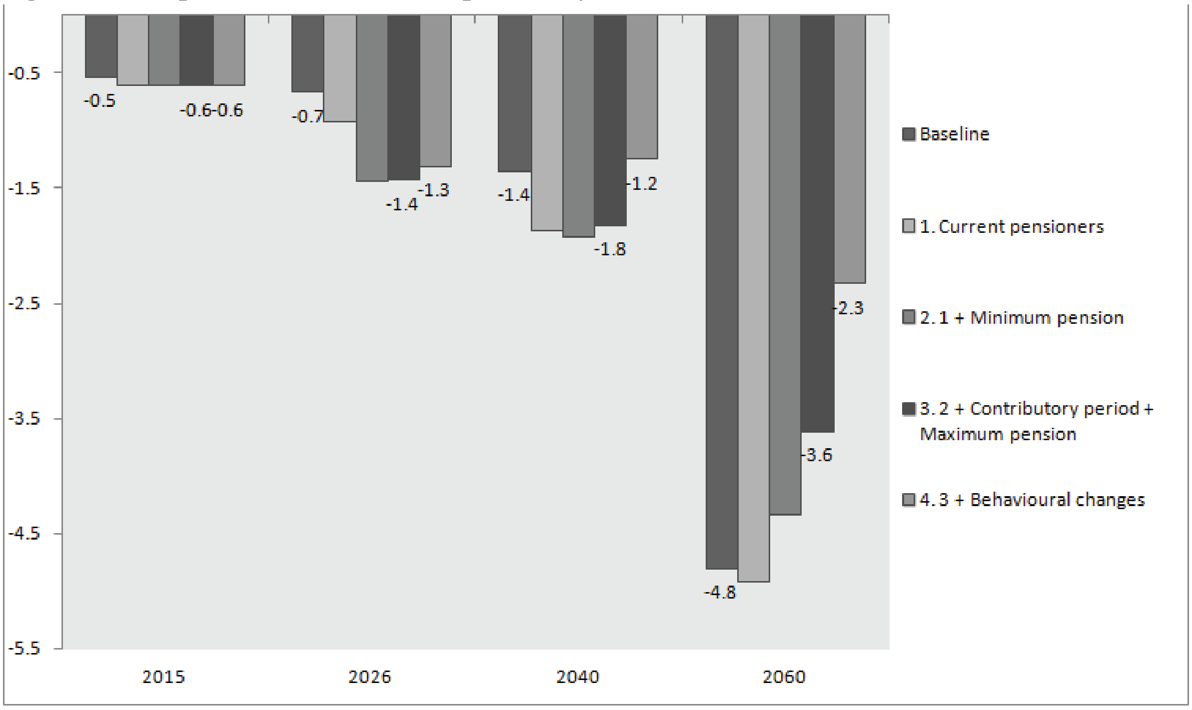
05 IMPACT OF THE PROPOSED REFORM TO THE PENSION SYSTEM

The impact of the key structural reforms to the pension system architecture recommended by the Strategy Group can be grouped into 4 sets of inter-linked measures. The first consists of those measures directly relating to current pensioners: namely changes to indexation better credits and survivors' benefits. As can be seen from Figures III and IV, these reforms rise spending and lead to a slight worsening of the deficit, but this effect starts dying off after 2040.

The reforms to the minimum pension also raise spending over the next decade or so, but thereafter the reform would lead to an improvement in the system balance. The proposed changes to the contributory period and the maximum pension indexation would also impact spending and the system deficit positively, but only after 2040. This strategy reflects the fact that up to 2040, Malta's projected pension spending is in line with that in the rest of the EU, and the required recalibration of the pension system is clearly required in line with the unforeseen improvement in generosity of the system post-2040 and consequential worsening of its sustainability.

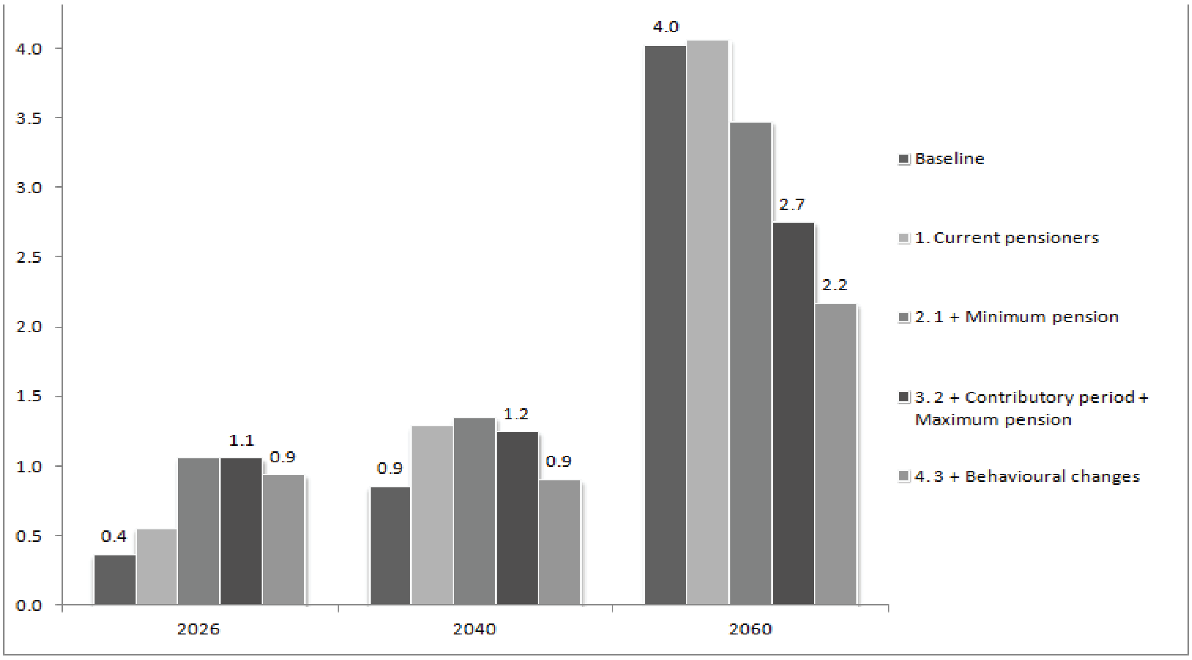
The first sets of reforms assume no behavioural change on the part of contributors. With the aid of World Bank experts, the Strategy Group, however, simulated the possible impact that these reforms could have on labour market behaviour, particularly on early retirement. The results are quite promising.

Figure 07: Impact of reforms on the pension system balance:



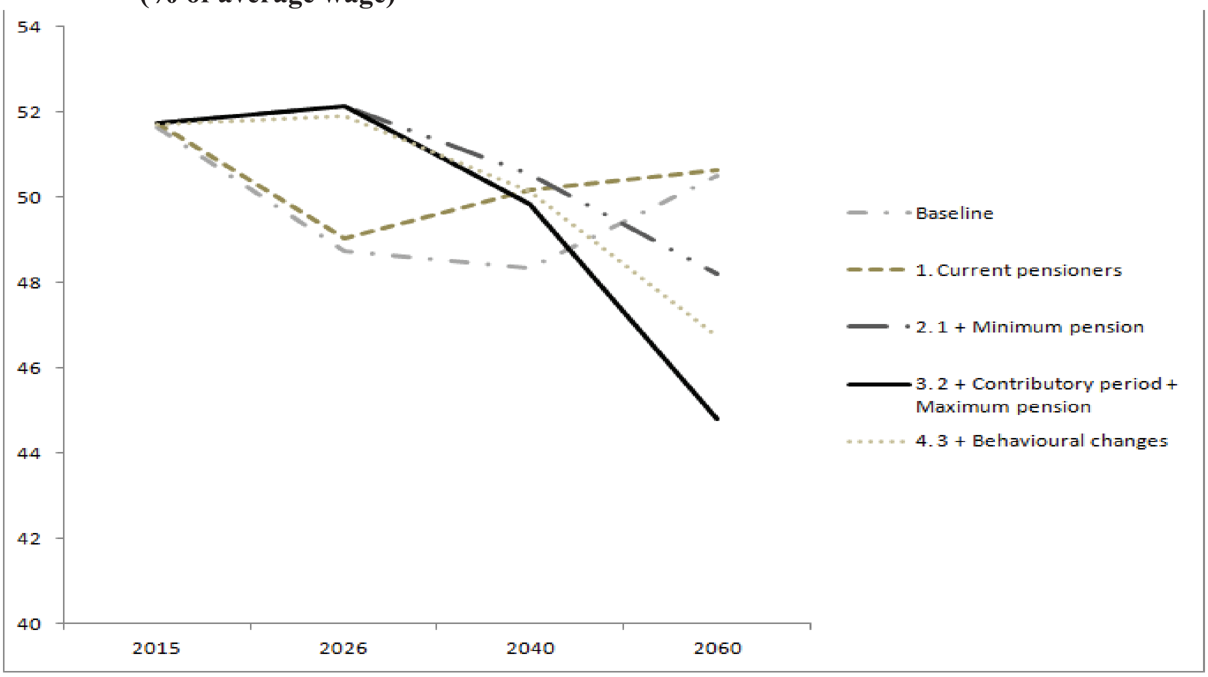
While with no behavioural changes, the system deficit would be improved from 4.8% of GDP in 2060 to 3.6% as a result of the proposed reforms; if labour participation responds as expected, the improvement would be to 2.3% of GDP in 2060. The main impact of the behavioural changes would be to raise revenue, by increased labour market participation rather than lower expenditure by reducing adequacy or increase statutory retirement age.

Figure 08: Impact of the reforms on the increase in pension spending compared to 2015 (% of GDP)



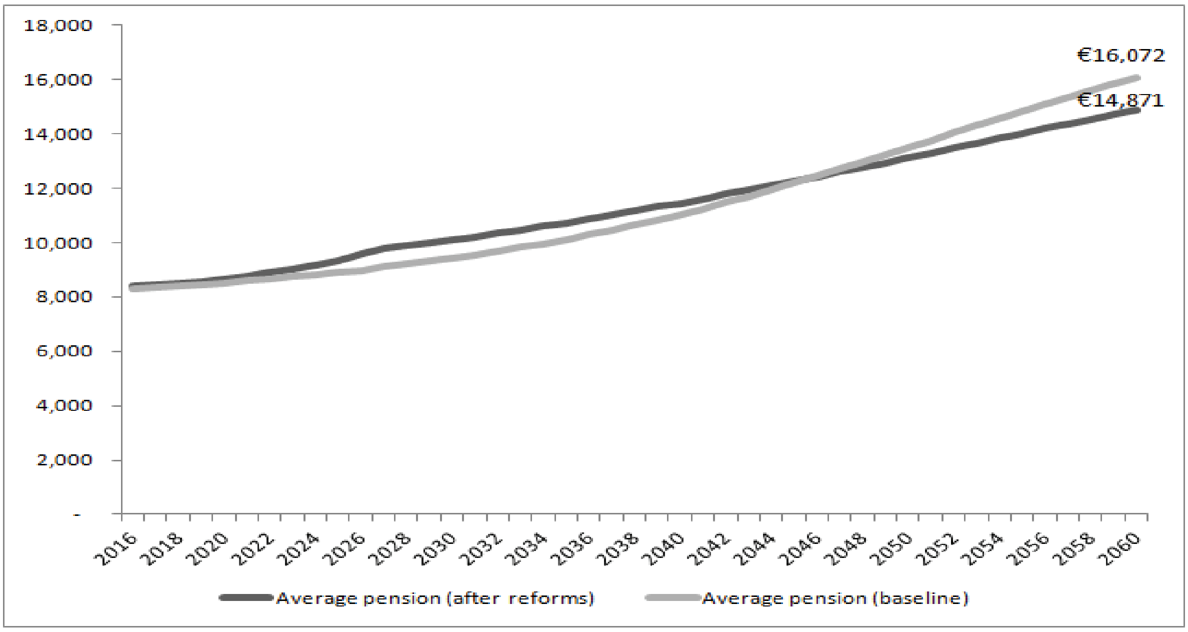
As can be seen from the Figure above, with no behavioural changes, the average generosity of the pension system – after the proposed reforms – would decline gradually to 45%, the same level projected in the 2007 pension reform. On the other hand, if labour participation reacts to the changes, the decline is more muted – 4.9 p.p. compared to the 9 p.p. anticipated in the 2007 reform.

Figure 09: Impact of these reforms on the Average Pension Replacement Rate (% of average wage)



It is also important to note that whilst the replacement rate is forecasted to decline, the level of the average pension, taking into account the projected increase in living costs, will still grow significantly over time. In fact, up to the mid-2040s the reforms are set to enhance the value of the average pension compared to the current rules, as can be seen in Figure VI. By 2060, the level of the average pension will be some 7% lower than under current rules, but its level will still be 77% higher in real terms than it is now.

Figure 10: Impact of these reforms on the Average Pension in 2016 constant prices



The recommendations presented by the Strategy Group with particular regard to those titled ‘Reforms to the Pension System directed to ensure a Socially Sustainable System that provides for a Fair Balance between Contributions and Benefits across Generations’ 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 Strategy Group has sought to address. The Strategy Group underlines that policy-makers should avoid the temptation to cherry pick. Rather, the Strategy Group urges the recommendations to be embraced in their totality.

RECOMMENDATIONS PROPOSED BY THE PENSIONS STRATEGY GROUP

The following are the recommendations proposed by the Pensions Strategy Group:

Reforms that Address Changing Needs and Issues relating to Society and the Labour Market

Recommendation 01:
Crediting Contributions for Child Rearing, Family Growth, and Gender Equality

The Pensions Strategy Group is of the considered opinion that the child rearing credits framework is recalibrated to meet three objectives: (a) counter the discriminatory impact of the traditional social model on career breaks experienced by females for child bearing and rearing; (b) encourage mothers to be more active in the labour market; and (c) leverage the pension system to positively impact fertility. The Pensions Strategy Group, therefore, recommends that the child rearing credit is calibrated as follows:

Child	Transitional	Switchers	Severely Disabled Child (with a Disabled Child Allowance)
Child's Age Limit	6 years	6 years	10 years
Credit for First Child	3	5	
Credit for Second Child	2	4	
Credit for Third Child	1	3	
Credit for a Disabled Child	4	8	
Qualifying period of fully paid contributions to benefit from credit contributions for child rearing		1st January 2016 increases from 10 to 12 years	

The mandatory qualifying period to qualify for the pension, and to start to benefit from the credits scheme under Section 16 (a)(d) of the Social Security Act should increase from 10 years to 12 years as follows:

- No change for persons born from 1962 and 1965 to keep with the principle that persons should be informed 15 years in advance vis-à-vis changes that effect pension rules.
- To 11 years for persons born between 1966 and 1967.
- To 12 years for persons born on and after1968
- Required period may be reviewed as part of the 5-year strategic review with a view that it continues to bear a direct relation to the contributory period required for a full pension.

Article 16(2)(d) of the Social Security Act which states that "such credits shall only be awarded insofar as, prior to the pension age, such father or mother, as the case may be, resumes gainful occupation for a minimum period equivalent to that period for which such number of credits would have been awarded" should be removed so that such credits are awarded regardless of length of employment. These recommendations will also apply with regard to adopted children.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Recommendation 02:
Crediting Contributions for Human Capital Development and Life Long Learning

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 Pensions Strategy Group recommends that the contributions of persons who hold tertiary qualifications that are recognised by the Malta Qualifications Recognition Information Centre are credited as follows:

	Transitional	Switchers
Level 5 and Level 6	2 months per year of studies	3 months per year of studies
Level 7	3 months per year of studies	6 months per year of studies
Level 8	6 months per year of studies	12 months per year of studies

The Pension Strategy Group further recommends the introduction of a lifelong learning credit of 1 month for each aggregated year of accredited courses for persons who are 18 years of age and over, including those who follow formal apprenticeships or academic or vocational higher education with an education institution and a training / education programme that is registered with Malta Qualifications Recognition Information Centre, is introduced.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Recommendation 03:
Accounting for Contributions Paid under the age of 18 by persons born before 1962

The Pensions Strategy Group recommends that contributions paid under the age of 18, by persons born before 1962, are taken into account in the determination of pension entitlement.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Recommendation 04:
Removing the Ceiling on the Payment of Contributions Post-65 Years of Age

The current ceiling of 65 years on the payment of contributions by employers and employees is an obstacle to encouraging and incentivising more active participation of elderly persons and it is recommended that discussions take place within MCESD and MEUSAC, with a view to possibly remove this ceiling and that the individual and the employer will pay NI contributions as long as that individual remains active in the labour market.

Recommendation 05:
Reconciling Atypical Employment with the Contributory Principle

The Pensions Strategy Group recommends that the pension system is to reflect emerging employment patters 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 a 40 hour week irrespective of the number of employers the person is engaged with as a part-time worker.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Recommendation 06:
Facilitating the Transition of Workers from the Shadow to the Formal Economy

The transition of workers from the shadow to the formal economy has two strategic imperatives with regard to pension reform. The first is that it increases employment participation rates and, thus, strengthens the sustainability of the pension system. The second is that it reduces the 'social protection deficit' that persons in the shadow economy are exposed to and hence renders them eligible for contributory pension support; and, thus, improve adequacy.

The Pensions Strategy Group recommends that the Government undertakes 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 shadow behaviour at the first instance. It is proposed that the Government establishes, at the earliest possible, a multi-disciplinary team to draw up a holistic strategy directed to tackle the shadow economy in Malta.

Recommendation 07:
Introducing an Economic Migration Policy for Malta

The Pensions Strategy Group recommends that the Government designs and introduces an immigration policy that targets high and semi-skilled competencies, skills and knowledge as a measure to strengthen Malta's human capital and labour market challenges arising from population ageing. It is proposed that the Government, at the earliest possible, designs and introduces such an economic immigration policy.

The Strategy Group further proposes that action is taken to regularise the status of current immigrants so that these are in a position to positively contribute to Malta's economy. This will not only productively muster the competencies and skills that such persons possess but will eliminate the possible abuse where such persons are illegally engaged at a pittance and with no employment rights.

Recommendation 08:
Incentivising Active Participation of Elderly Persons through the Removal of the Mandatory Retirement Age

The Pensions Strategy Group understands that there cannot be an abrupt transition from a pension system – and labour market – that is governed by a Statutory Pensions Retirement Age which is also the Mandatory Retirement Age to one that abolishes the Mandatory Retirement Age criterion on age equality based legislation. The Pensions Strategy Group underlines that such a debate cannot be ignored and recommends a process of discussion under the tutelage of the Malta Council for Economic and Social Development with the aim of leading to a possible abolition of the Mandatory Retirement Age.

Reforms to the Pension System directed to ensure a Socially Sustainable System that provides for a Fair Balance between Contributions and Benefits across Generations

Recommendation 9:
Strengthening the Inter-generational Social Contract through a PAYG Notional Defined Contribution Pension System

With the assistance of the World Bank, the Pensions Strategy Group studied the implementation of a Notional Defined Contribution pension system in Malta and concluded that such a complex systemic change was deemed to be inappropriate given the presence of a rather strong Guaranteed National Minimum Pension which makes the system unlikely to deliver satisfactory results in terms of enhancing pension adequacy and sustainability.

Recommendation 10:
Ensuring a Fair Balance between Contributions and Benefits Across Generations

The Pensions Strategy Group considers the introduction of the 5 year strategic review of the pension system as a positive development and that this should be strengthened through the setting up of a special body which every 5 years would establish the parameters of the pension system architecture with a view of announcing changes necessary to maintain balance between contributions and benefits across generations, 15 years in advance and thereby ensuring that persons can make appropriate adjustments.

Recommendation 11:
Ensuring a Fair Balance between Contributions and Benefits Across Generations

The Pensions Strategy Group recommends that for the pension system to remain equitable across generations, the social contract underpinning pension transfers needs:

- To be able to adjust gradually to changing demographic conditions.
- While allowing individuals the flexibility to retire at their respective pension age, the contribution period required to qualify for a full pension needs to be based on a stable ratio between the number of years contributing to that spent drawing the benefit.
- The growth of the maximum pensionable income to reflect changing demographic conditions so as to provide a better deal for future contributors.

Recommendation 12:
Ensuring a Fair Balance between Contributions and Benefits Across Generations

The Pensions Strategy Group underlines that a contribution period that reflects a full career definition would be a truer and fairer mechanism than the contributory period currently in place in the pension system in so far that a balance is maintained with changing needs and issues relating to society and the labour market. The Pensions Strategy Group recommends that any tightening of the relationship between the contribution period and a person's work life should be gradual.

It further proposes that the first tightening in this relationship should be introduced as at 1st January 2016. This presents a minimum of 15-year-in-advance announcement to persons who today are aged 50 years or less (born in 1965 or after). The contributory period for this cohort of persons is being proposed to increase from 40 to 41 years.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Recommendation 13:
Incentivising Late Exits from the Labour Market

The implementation of Article 62A provides an 'exit route' from the labour market despite of the Statutory Pension Retirement Age set respectively for the Transitional Group and the Switchers Group. The Pensions Strategy Group, therefore, recommends the following measures directed to incentivise persons to remain active in the labour market:

- A person will receive the following top-up to his or her pension in the event he or she remains in employment between 62 and 65 years of age without claiming pension:

62 years of age:	2% top up to the pension value
63 years of age:	2% top up to the pension value
64 years of age:	4% top up to the pension value
65 years of age:	4% top up to the pension value.

This will constitute a permanent increase in the person's pension income.

- To give a better incentive to those working, the Group recommends that:

  The number of contributions that need to be paid (that is, not credited) for one to retire earlier than actual retirement age should be established to be at least 7/8s (around 35 years) of the total required (Invalidity Pension credits would be considered as paid for this purpose). This condition shall apply only for those born in 1962 or after and introduced gradually as follows:

  - Those born from 1962 to 1968 – no change
    (to keep with principle of informing of changes 15 years in advance)
  - Those born in 1969 – 31 years out of 41 years need to be paid
  - Those born in 1970 – 32 years need to be paid
  - Those born in 1971 – 33 years need to be paid
  - Those born in 1972 – 34 years need to be paid
  - Those born in 1973 or after – 35 years need to be paid.

The above is being proposed to be reviewed every 5 years in line with future changes resulting from Recommendation 12.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Recommendation 14:
Incentivising the Deferral of a Retirement Decision

The Pensions Strategy Group recommends that a person may opt for late retirement - that is s/he remains in employment post the Statutory Pension Retirement Age of 65 years of age and during which period s/he defers his or her pension until he / she formally retires - will on eventual retirement receive a far higher pension income for life; the derived right of which will also be enjoyed by the widow/er.

A person who defers his or her retirement and pension beyond 65 years will see the pension increase annually in a compound manner for every full year of deferment.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Recommendation 15:
Defining the Guaranteed National Minimum Pension

The Pensions Strategy Group, thus, recommends that the Guaranteed National Minimum Pension (GNMP) should be set at poverty threshold which is known as at 1st January 2016 (2016 is the proposed point of entry of the gradual phasing in of the GNMP for all in line with the current Government's Electoral Manifesto proposal). Between 2017 and 2026, the GNMP increases by the full COLA for that year plus any difference between the full COLA and the income level resulting from the application of an indexation of 50% wages and 50% inflation. Thereafter, the GNMP will increase cumulatively on the basis of the full COLA plus any difference between the full COLA for that year and the change in the maximum pension (resulting from the 70/30 indexation mechanism) as is already the case for persons due to retire after 2026. The value of the GNMP will be further reviewed every 5 years, as part of the strategic review of the pensions system, with the next review due by 2020.

The proposed GNMP mechanism should be introduced in a phased manner for all pensioners targeting at the first instance the most vulnerable pensioners: pensioners who as at 1st January 2016 are 76 years of age and over. Thereafter, the Guaranteed National Minimum Pension should be extended to further pensioners on the basis of the following implementation schedule:

Age	Year
76 and over	2016
75	2017
74	2018
73	2019
72	2020
71	2021
70	2022
69	2023
68	2024
67	2025
66	2026
65	2027

The GNMP does not specify a married rate and hence pensioner couples with just one income will be at-risk-of-poverty. To counter this, the Pension Strategy Group recommends that a top-up is added to the Supplementary Allowance to ensure that married pensioners on the GNMP will not be exposed to being at risk of poverty.

Recommendation 16:
Establishing Relativity of the Old Age Pension with the National Minimum Wage

The Strategy Group is of the considered opinion that the Old Age Pension is linked to the National Minimum Wage so that any increases to the latter would automatically result in increases to the Old Age Pension. The following is recommended:

Single	66.7% of the National Minimum Wage
Married (both qualify)	80% of the National Minimum Wage
Married (one qualifies)	50% of the National Minimum Wage - with the rest of the COLA adjustment to be paid through social assistance payable to the spouse under 60.

<u>Recommendation 17:</u>
<u>Synchronising the Old Age Pension Retirement Age with Article62(A) of the Social Security Act</u>

The 2007 reform did not increase the retirement age of the Old Age Pension to render it consistent to reforms presented in Article 62(A). This was the result of oversight. The Pensions Strategy Group considers the retirement of 60 years of age for the Old Age Pension as a potential 'formalised' exit route from the labour market and recommends that this is increased to 61 years of age to render it consistent with the contributory retirement age. The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

It is proposed that this measure is introduced incrementally with implementation to initiate in 2016 and scheduled as shown in the Table below.

Age	Born
62 years	1954 and 1955
63 years	1956 to 1958
64 years	1959 to 1961
65 years	In or after 1962

Reforms outside of the Pension System to ensure that it is not the Only Source of Income

Recommendation 18:
Introducing Incentives for a Voluntary Third Pension

The Pensions Strategy Group supports the recommendations of a Technical Committee to the Minister for Finance with regard to the contribution allowance, the key eligibility criteria, and the amendments to the Social Security Act, the Income Tax, and supporting Legal Notices respectively.

Recommendation 19:
Nudging Persons to Save for Retirement

The Supporting Retirement Pension Scheme that is to be introduced in 2014 may be subject to heuristics which will influence behaviour with regard to long term planning and savings, particularly given that the scheme is completely voluntary. The Pensions Strategy Group recommends that during 2020 Strategic Review, the proposed pension commission (Recommendation 10) should carry out an in-depth review on the performance of the scheme. In the event that the Review shows that voluntary pensions would not have delivered as planned, it should strategically assess the introduction of Mandatory Opt-In Voluntary Opt Out framework, which would see the employer responsible for managing the administration aspects of the scheme and the government responsible for the fiscal incentive is carried out.

Recommendation 20:
Accessing Wealth Accumulated in Property for Retirement Income

The Pensions Strategy Group proposes that the Government should conduct a study to assess the scale of the informal Equity Release market, and carry out a study of the possible take-up of more formal arrangements including the setting up of the Home Equity Bank, either through EU funds or borrowing from multilateral institutions, such as the European Investment Fund or the National Development Bank mentioned in the Government's electoral manifesto. It is proposed that the Government initiates work on this recommendation at the earliest possible.

Recommendation 21:
Inculcating a Culture of Literacy with regard to Financial Savings and Investments and Retirement Income

The Pensions Strategy Group agrees with the direction proposed by the 2010 Strategic Resource in the setting up of a leading structure that would result in the articulation of a financial and retirement income strategy and which would coordinate its implementation. The Pensions Strategy Group recommends the re-constitution of the Commission for Financial Literacy and Retirement Income which should be assigned the following terms of reference:

- Use of educational pathways across the school curriculum, further education, adult and community education and education in the workplace.

- Provision of trusted and independent information to change behaviour and on-going support including but not limited to a targeted designed website, digital markets and social and traditional media.

- Inculcating a new culture by increasing understanding of how consumers act, introducing new strategies such as soft compulsion and addressing gaps in existing advice services.

- Work in partnership with the government, the financial services market, the regulatory authorities and other constituted bodies in establishing new ways to strengthen the connections between all parties that are involved in financial services and retirement income.

It is recommended that this reform measure is implemented by Government at the earliest possible.

Reforms to Address Challenges Faced by Current Pensioners

Recommendation 22:
Maximum Pensionable Income

The Pensions Strategy Group disagrees that the Maximum Pensionable Income parameter established for the Switchers' Group in the 2007 reform creates an anomaly with regard to the Transition and Exempt Groups. The Switchers Group unlike the other two Groups faced the full brunt of the 2007 reform. The options presented by representatives of the pensioners' organisations will result in a significant financial impact for measures that will be enjoyed only by a very small number of pensions. This will constitute a benefit for which current pensioners did not contribute for and which would be borne by future pensioners, who are operating within a pension system that is far more rigorous and facing significant risk as a result of uncertainty.

Recommendation 23:
Annual Re-Assessment

The Pensions Strategy Group concludes that current pension annual re-assessment is governed by an annual Collective Agreement assessment whilst the pension income of all other pensioners is increased by the COLA is socially unjust as it provides no protection to workers who are not covered by a Collective Agreement. The Pensions Strategy Group recommends that the current Collective Agreement based re-assessment for current pensioners and persons within the Exempt and Transitional Group is abolished and replaced by an indexation mechanism based on the following formula:

> Pension increases annually by a % (percentage) of a ratio of [50% Wage Growth : 50% Inflation Growth] or the full COLA whichever is the highest.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Recommendation 24:
Calculation of Pensionable Income for Persons in the Transitional Group

The current calculation is based on the best 3 years of the last 11, 12 and 13 years for employed persons and the best 10 years for self employed persons within the Transitional Group, depending when born. This is seen to cause a handicap for such persons who may have lost good paying jobs or underwent difficult business cycles in the the last 11 to 13 years. The Pensions Strategy Group recommends that by not later than 2018, the pensionable income for the Transitional Group is calculated as follows:

- Best 3 consecutive years in the last 15 years for employed persons born from 1952 to 1961.
- Best 10 consecutive years in the last 15 years for self employed persons born from 1952 to 1961.

It is recommended that such changes be also effected for persons already on pension before implementation date, but the change becomes effective from start date onwards

Recommendation 25:
Gender Equality

The Pensions Strategy Group recognises the merit of the recommendation presented by pensioners' organisations that the Survivor's Pension should be replaced by the eligible full pension as the current Survivor's Pension is gender discriminatory and fails to take into account a woman's economic contribution as a family carer during her lifetime. Be that as it may, Strategy Group concludes that the adoption of this proposal in its current form is not affordable and should be rejected.

Recommendation 26:
Gender Equality

The Pensions Strategy Group recommends that the surviving spouse will get the deceased spouse's full pension as opposed to the 5/6th today provided that the surviving spouse has or would have a right to a pension in her own right. In the eventuality that the latter is higher, then she would continue to receive the latter.

Recommendation 27:
Service Pension

The Pensions Strategy Group recommends that the 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.

The Pensions Strategy Group proposes that Government implements this recommendation in 2016.

Public Consultation

This is an Abridged Version of the Main Report prepared by the Pensions Strategy Group. The full report and relevant documentation may be viewed on www.mfss.gov.mt.

The general public is invited to give its feedback about the proposed pensions strategy and make its suggestions. Such feedback can be sent by 17th July 2015, either by email on pensions.strategy@gov.mt or by post to:

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