4 August 2011

Mr David Spiteri Gingell
Chairperson
2010 Pensions Working Group
LoQus Business Intelligence
F26 Mosta Technopark
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Dear Mr Spiteri Gingell

Re: Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pensions System

The Malta Institute of Accountants (MIA) would like to thank you for the opportunity to comment on the recommendations set out in the above mentioned consultative document and is pleased to provide you below with its comments in that regard.

As an Institute we welcome the publication of the consultative document, we commend the Pensions Working Group's and the Minister of Social Policy's initiatives aimed at ensuring the adequacy, sustainability and social solidarity of the pensions system, and we look forward to participating further and adding value to this important national debate.

1. Introduction

1.1 We would like to take the opportunity at the outset to congratulate the 2010 Pensions Working Group (2010 PWG) for the high quality of the above mentioned consultative document. There is no doubt that the adequacy and sustainability of the pensions system is an extremely important issue for all jurisdictions, not least for Malta, as it has a direct impact on the standard of living that a country's aging population is or will be able to enjoy. In view of these far reaching consequences, the Institute would urge the 2010 PWG to create more awareness on the publication of this document, make it more easily accessible to the general public and, equally important, provide a non-technical executive summary of the recommendations (and perhaps some background to the recommendations) which can be easily understood by the non-technical reader.

1.2 In general the Institute is of the view that the public at large still has to appreciate the significance of this issue and the impact that this will have on their post-retirement livelihood if they refrain from taking action at the earliest opportunity. Hence, together with an appropriate and timely educational and awareness campaign, the Institute is

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also urging the Minister of Social Policy to activate and incentivise the Third Pension system as soon as practicable thus giving persons the opportunity and the appropriate vehicle through which they can start investing savings for their eventual retirement.

1.3 Prior to setting out our comments on a number of specific recommendations, it is pertinent to point out that the Institute could not comment on all 45 recommendations and focussed its attention on the ones which are more relevant to the accountancy profession and those on which the Institute can add greater value.

1.4 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Undoubtedly the pensions debate carries a significant degree of public interest. The Institute's comments therefore come from two different hats: the public interest hat and the profession's interest hat.

2. Measures aimed at increasing the labour participation of females

2.1 Recommendations 4, 10, 11, 13 and 14, directly or indirectly, aim to increase female participation in the labour market.

2.2 As the Institute represents a profession in which the majority of new entrants over the better part of the last decade were of the female sex, the MIA cannot but endorse such measures. Low participation of females in the labour market is a sensitive issue for the accountancy profession and measures which aim to retain females in the labour market and potentially attract others who are already on indefinite career breaks are looked at very positively by the Institute.

2.3 One such measure is outlined in Recommendation 4 which proposes to grant credits to compensate for any child rearing career breaks as such interruptions render it "even harder for a female to achieve the full contribution period"[1]. While noting that such a measure is expected to have a positive effect on the country's birth rate, the MIA is of the view that such a measure should be availed of by either parent, rather than merely the mother as being proposed in the recommendation. Government has invested heavily in an educational and awareness campaign which aims to create a burden sharing culture whereby the child rearing and financial burdens are shared between both parents and, today, it is not uncommon to see fathers opting for a child rearing career break especially where the main breadwinner is the mother. Hence the Institute recommends that credits to compensate for child rearing career breaks should be given to **any** of the parents who assumed child rearing responsibilities, who may not necessarily be the mother.

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[1] Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pensions System, Recommendation 04, p.28.

3. Gaps in 40 Year Contributory Accumulation Period of Higher Education Students

3.1 Recommendation 24 recommends that the Government should consider amending the Social Security Act to allow persons who have a gap of up to five years in their contributory history as a result of following higher education are to be provided with the opportunity to fill those gaps on the condition that the contributory rate paid is the maximum contribution rate due on the date the application to fill in the gap is made.

3.2 As members of the accountancy profession are increasingly pursuing further tertiary education, the MIA endorses this recommendation. However, we are of the view that the recommendation needs to be refined and we are pleased to set out below our recommendations in that regard.

3.3 First, we believe that the contributory rate at which the gap is to be filled should be the rate that would have applied had the person been employed during the period while he or she was pursuing higher education. This could be calculated as the average of the rates that applied immediately before and immediately after the 'study period'. Moreover, any gaps should be filled within three years after the person has resumed employment. We believe that such a system would have the following advantages:

(a) It would be more equitable as it fills any gaps at the earliest opportunity for the benefit of both the employee and the pension funds, rather than filling such gaps after a number of years possibly even immediately before one's retirement;

(b) It eliminates any fluctuations in the real value of contributions paid as a result of changes in the retail price index over time; and

(c) It ensures that any missing contributions are paid and hence brought into the pensions system at once, hence not losing the benefit of income and capital accumulation that those contributions would yield over a number of years.

3.4 Secondly, we believe that the recommendation merits a clarification as to whether any of the employers with whom a person was employed before or after the 'study period' would be expected to pay any contributions for those gaps. The Institute is of the view that neither employer should carry such a burden.

4. Shifting from a Pay-As-You-Go to a Notional Defined Contribution First Pension System?

4.1 Recommendation 25 encourages Government to appoint a working group to look into the possibility of transforming the current PAYG system into a Notional Defined Contribution First Pension.

4.2 Cognisant of the fact that there are significant issues that would have to be addressed in particular on the financing of existing pensions if NI contributions start being ring-fenced into individual employees' accounts, the Institute nonetheless supports the establishment of such a working group and looks forward to the opportunity to comment on the working group's recommendations.

4.3 Moreover, the Institute would be interested in participating in, and contributing to, this important national debate.

5. Introducing a Mandatory Second Pension

5.1 Chapter 5 of the consultative document deals with the introduction of a mandatory second pension and a number of recommendations have been proposed by the 2010 Pensions Working Group in that regard. We focused our attention on recommendations 26, 30 and 31.

5.2 Recommendation 26 urges government to consider introducing a Mandatory Second Pension directed at persons who are aged 45 years and younger at the time when it is introduced. Although in principle the MIA agrees with the introduction of a second pension, we believe that for one to comment constructively on this Recommendation more information, such as to what extent would the pension replacement rate improve as a result of the Mandatory Second Pension, ought to have been given in the consultative document.

5.3 Moreover, from our reading of Recommendation No. 63 taken from the PWG June 2005 report and reproduced on page 68 of the Consultative Document, we noted a possible anomaly between the contribution rates applicable to employed and those applicable to self-employed persons. Recommendation No. 63 seems to suggest that, by the year 2025, the total contribution paid into an employed person's account would be 8% (4% employer + 4% employee) while the total contribution paid into a self-employed person's account would be 4%. Perhaps the Recommendation should be clarified if this was unintentional. If, on the other hand, the wording of the Recommendation is a fair reflection of the Working Group's proposals, the MIA encourages Government to consider the equitability of returns between employed and self-employed persons.

5.4 Government should also consider, and if possible quantify, the effects that the contribution to a second pension would have on employers and Malta's competitiveness. A Mandatory Second Pension would make commercial sense only if the benefits obtained (i.e. the amelioration of the pension replacement rate) outweigh the costs involved in establishing such a system (i.e. the increased contributions paid by employees and borne by employers).

5.5 In its 30th Recommendation the 2010 Pensions Working Group recommended that the introduction of a Mandatory Second Pension should be supported by a Default Fund framework in which people would be de facto enrolled if they fail or are unwilling to make an investment choice. It also urged Government to consider inviting the MFSA to present recommendations on the most appropriate framework for the design and grafting of such a Default Fund onto the Mandatory Second Pension Framework.

5.6 The Institute sees a significant degree of public interest involved in the administration of second pension funds, especially the 'off the shelf' Default Fund in which persons are required to enrol if they fail or are unable to make their own investment decisions and opt for other appropriately licensed second pension funds. The MIA therefore calls for complete transparency in the setting up and the running and administration of the Default Fund and seeks clarifications on the following issues amongst others:

- The criteria on which the investment management tender will be awarded. The Institute believes that such criteria need to be transparent.
- What will the Default Fund's investment objectives be?
- In what types of investments will the Default Fund be expected to invest?
- How long will the investment manager's term be?
- On what grounds can an investment manager be replaced?
- Will there be any contingency plans in the event that, for example, an investment manager resigns or withdraws its presence from the Maltese islands?

5.7 Recommendation 31 encourages the Ministry for Pensions and the MFSA to look into mechanisms that would aim for the most optimal administrative cost structure for the Mandatory Second Pension.

5.8 Noting the sensitivity of retirement income to fluctuations in the management charges (refer to page 91 of the consultative document: "A study by the UK Department of Work and Pensions (May 2006) shows that under a 1.5% management charge, an individual saving for 40 years will lose around 20% of the potential pension income compared to a charge of 0.5%") the MIA **strongly endorses** the working group's recommendation that **fees should be controlled** as such a mechanism would definitely be in the public interest. In order to keep administrative costs for the Mandatory Second Pension down to a minimum perhaps Government might consider joining in another country's Default Fund should circumstances permit.

6. Establishing a Third Pension Framework and Introducing Alternative Voluntary Mechanisms for Saving for Retirement

General comments

6.1 The Malta Institute of Accountants is of the view that it is now opportune for the Minister for Pensions to activate the Third Pension System and encourages Government to do so at the earliest opportunity without the need to tie the activation of the Third Pension with the activation of the Second. The MIA believes that the two are very separate issues and, given that the activation of a voluntary Third Pension should neither be politically controversial, nor excessively bureaucratic, and should not translate itself into extra burdens for employers, the Third Pension system should be activated at once.

6.2 As the Institute's Members' are close to all Maltese businesses that matter, the Institute is at a vantage point when it comes to assessing and understanding the extent that certain issues have on local businesses and their employees. Against this backdrop the MIA is of the view that there is a huge lack of awareness amongst the general public about the inadequacy of the First Pension and how this will impact their post-retirement standard of living. As a result the MIA urges the Ministry for Pensions to engage in an educational and awareness campaign at the earliest opportunity which, at least in its early stages, should start by promoting investment in a Third Pension system. Such a marketing campaign should be directed to higher income earners, of which professionals generally from part, in view of the following:

(a) High income earners are at risk of having a much lower pension replacement rate than average income earners; and
(b) High income earners have more disposable income that can be 'set aside' and invested in a Third Pension. Tax incentives should nonetheless be in place to incentivise such people to set aside 'extra' funds in a third pension.

Establishing a Third Pension Framework

6.3 The MIA is pleased to note that, as stated in Recommendation 32, the 2010 Pensions Working Group shares the Institute's views on the urgency with which a Third Pension framework needs to be set up. The MIA reiterates its view that the activation of the Third Pension is both crucial (especially for higher income earners – see our comments in the preceding paragraph) and urgent.

6.4 The MIA believes that the activation of a Third Pensions framework should be preceded by an educational and awareness campaign. The objectives of such a campaign would be, amongst others:

(a) to create awareness on the seriousness of the issue;
(b) to make people realise that investments need time to generate appropriate returns and hence one needs to save for his or her pensions over a sufficiently long period of time.

Such a campaign needs to be launched at the appropriate time, e.g. after Pension 3 certification by MFSA, after the necessary mechanisms are in place to take on the wave of first movers who would react to the information campaign after the appropriate tax incentives have been implemented.

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Implementing tax incentives to spur people to invest in a Third Pension

6.5 The MIA endorses the implementation of a tax incentives framework to spur people to invest in a Third Pension, as being proposed in Recommendation 34. We believe that unless such incentives are enacted, people may be reluctant to 'give up' net disposable income for eventual 'use' in the too distant future.

Creating a fast track route to individual private pension accounts

6.6 Recommendation 37 proposes that Government should work with appropriate stakeholders to devise a way forward through which existing financial products on maturity can be converted into locked pensions saving.

6.7 The MIA agrees that there is an opportunity to fast track the introduction of pension saving as being proposed in Recommendation 37 however, the Institute is of the view that an equitable position is necessary in order not to discriminate against existing savers who have saved money out of their taxed income before conversion to a Third Pension scheme. Tax incentives should therefore be tied to such conversions.

6.8 We believe that we have the expertise to contribute and add value to this discussion and the MIA would be willing to participate in this debate.

7. Conclusion

While thanking you once again for the opportunity to comment on the consultative document we remain available for any clarifications that might be necessary and would be pleased to meet in person as necessary.

Yours sincerely

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The Malta Institute of Accountants