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

## 2010 Pensions Working Group

**December 2010**
**Final Report**

## Executive Summary

The 2010 Pensions Working Group was tasked with the responsibility to carry out a Report "reviewing Part V of [the Social Security Act] ... with a view of achieving further adequacy, sustainability and social solidarity" as required by Article 64B of the said Act.

In preparing this Report and the accompanying Supplementary Papers the Working Group held a wide ranging consultation process with constituted bodies, stakeholders and engaged the World Bank to carry out studies on its behalf.

The intrinsic elements of the Maltese pensions system as reviewed by the then Pensions Working Group between 2004 and 2007 have not changed.

The White Paper issued by the Government in November 2004 which was followed by a broad consultative process that led to the submission of the Final Report in June 2005 which presented a comprehensive review of the pensions system and recommendations thereof. On the basis of the Final Report the Government undertook the most far ranging reform of the First Pension system – that is the PAYG National Contributory Insurance retirement pension – since its introduction in 1979.

These reforms were directed to secure the sustainability and adequacy of the pension of future generations. It is important to underline that the projected average replacement rate for the First Pension in this Report is 45% in 2060 – against the 18% it would have been if the 2007 reforms were not adopted. The parametric changes to the First Pension introduced in 2007 are deemed to have fulfilled their role as they braked what was an accelerated degeneration of the average pension replacement rate and thus stemmed the pension system from collapse.

It is pertinent to underline, however, that the recommendations proposed by the Pensions Working Group to Government in 2005 were not all accepted. Recommendations relating to the introduction of a Mandatory Second Pension and a Voluntary Third Pension were not embraced at the time.

The median pension replacement rate in proportion to the average wage as at 2009 is 54.7%. The PROST modelling estimates the average pension replacement rate to be approximately 50% of the average wage for pensioners between 2010 to 2015.

This, of course, excludes complementary support provided by the social security and health care system whether such support is universally provided such as health care, home care and community support; co-paid such as long term institutional residential care; and means tested such as energy support or pharmaceutical entitlements.

The modelled projections carried out for the period 2010 to 2060 in this Report show that the parametric changes to the First Pension project, as stated above, the average pension replacement rate of the First Pension will fall to 45% by 2060. Against this backdrop the Working Group argues that the pension system, despite the parametric reforms to the First Pension in 2007, will fall short of securing over time an average pension replacement rate that will bridge to the degree possible the quality of life to be enjoyed by a pensioner as compared to that enjoyed during his or her employment – a cardinal objective that a 45% replacement rate to the average wage will not secure even if one had to consider the fact that a pension is complemented by other health care or social security pensioner directed benefits.

Since the 2004 – 2006 worked carried out by the then Pensions Working Group the world has undergone through a financial and economic tsunami. The effects of this most severe financial and economic recession that the world has seen in decades has led respectable international economic institutions and economists to conclude that the crisis will leave a structural negative impact on the potential for economic growth in industrialised economies. Against this backdrop, a critical review of the economic growth assumptions underpinning the 2005 pensions review exercise is in order. While no clear consensus has yet emerged on the magnitude of the negative dip in potential growth the current economic crisis is leaving and will leave on the industrialised world's ability to grow, it is deemed proper by the Working Group to adopt more conservative views on the growth possibilities for the Maltese economy for the period projected.

To address this emerging reality the projections in this Report are subject to a different set of macro-economic assumptions than that applied in 2005. The macro-economic and demographic assumptions applied for the modelling in this Report are based on those agree for Malta by the Aging Working Group of the Economic Policy Committee which contributes to the work of the Economic Union Economic and Financial Affair Council and the European Commission.

The macro-economic assumptions agreed by the Aging Working Group are less ambitious than those used by the Pensions Working Group in 2005 and on Real GDP growth is expected to be around 1.75% for the period 2010 to 2060. Consequently, this assumption has contributed to the worsening in the pension system balance – especially during the last two decades of the projection when compared to the work carried out between 2004 and 2006. The Working Group notes that the Aging Working Group is in the process of reviewing the assumptions to render them more suitable to the post crisis reality. Thus, the Working Group is strongly of the opinion that the adoption of the Aging Working Group growth assumptions cannot be viewed as overly conservative.

As a PAYG system, the First Pension is intrinsically tied to demographics and the active labour participation rate. The demographics of the Maltese nation show that over the period modelled the population will decrease and the cohort of people over age 65 will increase significantly.

The risk of demographics will continue to place pressure on the First Pension and short term pro-natal policy action is unlikely to reverse this trend. A coherent and holistic pro-natal policy framework is required so that Malta reverses its low fertility rate over the long term.

Whilst the participation rate in the labour market in 2010 – which stands at 59% - continues to remain low this, however, does provide an opportunity to Malta to absorb, at least during the short and medium term, the negative impacts of a diminishing demographics on the PAYG by measures directed to bring the active participation rate equal to EU levels.

The low activity rate stems primarily from two population cohorts. The first is the female population cohort. Over the past decade, primarily, considerable investment was made by the Government in introducing family friendly policies and related infrastructure to allow females to take a more active role in the labour market. Unsurprisingly, increases in female participation in the labour market is most marked amongst the younger female cohorts whilst the 45 aged and over female cohort for, what is believed to be primarily cultural reasons, continue to opt to remain out of the market once they had previously opted out for family responsibility reasons or had, for the matter, never participated in the first instance.

This is seen to signify that whilst increases will continue to be experienced in female participation, rapid growth is not expected to be achieved until the current 45 aged and over female generation is replaced by the current 30 aged and under female generation. Additionally, the challenge to attract and retain females in the labour market remains and it is, indeed, of critical importance that action targeted at identifying and addressing root sources that are impeding females from playing a more active role in the labour market is carried out.

The second is retirees – particularly those who are aged 69 years and under. The presence of this particular cohort of the Maltese population in the labour market needs to increase significantly. In the event that the work place milieu in both the private and public sectors respectively with regards to this cohort of the population is aggressively remoulded considerable increases in their participation in the labour market should occur.

Additionally whilst Malta should undertake every effort to develop its indigenous human capital skills, skills deficits in the short to the long term should be bridged by a targeted immigration and residency policy which, whilst increasing the contributory base of the First Pension will also further engender economic growth and expansion over the long term.

Research and projections show that the longevity of the Maltese population during the period under review is expected to increase. In this regard, the Working Group recommends that Government should consider grafting onto the First Pension a retirement age-longevity indexation mechanism that would result in an increase in the official retirement age every time there is an official increase in the longevity index.

The attractiveness of such an indexation is that increases in the official retirement age would be based on a rational and non controversial formula that can be explained and understood by society at large. Moreover it secures a smooth and automatic process established within parameters that are both transparent and clear – and in doing so minimising potential political and social conflict.

This Report is of the considered opinion that the provision of the 5/6th Survivors Pension is gender discriminatory as it fails to recognise the female's economic value and the contribution of her role as a family carer and should be replaced by the retention of the full retirement pension earned by her former male spouse. This Report also recommends that the capping of the widow's pension to income earned that is not higher than the national minimum wage with regards to a female who is aged 22 years and over should be removed so that widows are incentivised to remain or re-enter the labour market.

Work practices indicate that traditional work practices are changing. Increasingly persons are no longer seeking a 40 hour week single employer relationship but rather a multiple employer relationship that will result in a 40 hour week. The Social Security Act is anachronistic with regards to atypical employment practices and the Working Group proposes that the necessary reforms are introduced in this regard.

A critical question that the New Pension Working Group grappled with is whether a Mandatory Second Pension remains a viable option in light of the recent experiences arising from the global economic and financial turmoil and if yes, when should it be introduced.

The Working Group concludes that a Mandatory Second Pension framework remains a viable instrument to diversify the intrinsic risk of demographics that destabilises the PAYG First Pension irrespective of further parametric reforms grafted onto it. Nevertheless, the Working Group is of the considered opinion that increased protection by means of a Default Fund based on a lifecycle investment strategy should be grafted to a Mandatory Second Pension Framework in order to provide protection to those persons who do not or are unable to decide how to invest and to manage that investment over their working period.

The question relating to the introduction of a Second Mandatory Pension must be answered with regards to the knowledge and certainty that an average pension replacement rate of 45% will not be adequate as against the uncertainty on the global economy and behaviour of the financial markets as well as its impact on the national economy.

After consideration of feedback received and much internal debate the Working Group concludes that a decision to postpone further a Mandatory Second Pension would only exacerbate the issue relating to the adequacy of the average pension replacement rate and thereby requiring, potentially, more drastic measures in the near future. Thus, the Working Groups recommends that the Government should seek to introduce a Mandatory Second Pension at the earliest possible.

The Working Group is recognisant of the import of this recommendation. For taking this decision forward the Working Group is of the considered opinion that the Government should invite the Opposition and relevant representatives of both employers and employees to participate in the design and implementation of a Mandatory Second Pension. Strategic and important decisions have to be taken with regards to matters such as what will the contribution rate be, how this will be appointed, will it be phased, et al. To the extent possible the introduction of a Mandatory Second Pension should be based on a national consensus.

The introduction of a Mandatory Second Pension will not happen overnight. Considerable preparatory work on soft and hard infrastructure will be required. Thus, in the interim the Government should consider introducing the Third Pension framework as early as possible in 2011 and establish the appropriate fiscal instruments to incentivise savings for retirement. Even in the event that fiscal incentives result in substitute savings, the Working Group concludes that given the state of play this would be a positive development as savings will be locked for retirement.

In the next ten years a high number of life endowment and other financial products will mature. This provides an excellent opportunity to fast track savings for pensions. The Working Group recommends that the Government should consider an incentivised framework to spur people to lock a considerable part of the maturity value of such instruments in savings for pension.

With regards to both the Third Pension and the potential conversion of the maturity value of existing financial instruments a pathway into the Mandatory Second Pension should be designed so that people who make a conscious decision to save for pensions today are not compelled to pay an additional contribution on a Mandatory Second Pension once this is introduced.

Data leads one to conclude that whilst savings have decreased investment in home ownership continues to increase. This seems to indicate that investment in home ownership is substituting savings. Home ownership, however, does not necessarily translate into liquidity. Thus the Working Group recommends that the Government considers the introduction of schemes such as Home Equity Release schemes to allow people, should they wish to do so, to leverage their home ownership investment into income during the retirement phase of their life cycle.

This recommendation is tempered by two concerns. The first is that property may end up concentrated in a small number of private owners – a state of play which, indeed, is already taking place today. Thus, the introduction of a regulatory framework together with measures to prevent property ownership concentration is seen to be of key importance.

The second is Second that although the local housing market has traditionally proven to be stable and has rarely, if ever, experienced a negative equity collapse, as experienced in countries such as the UK, Spain, et al, this does not mean that such a state of play may never take place in Malta. Thus, a further facet of the proposed study should be to gauge the risks that retirees investing in a home ownership pension product may be susceptible to.

The New Pensions Working Group recommends the following:

01. Whilst the 2010 Pensions Working Group is recognisant of the fact that maintaining the macro-economic assumptions adopted by Aging Working Group with regards to Malta for the period 2010-2060 leads to results that are far more negative than would otherwise be the case if a more positive macro-economic framework had to be applied given the fact that there is no local methodological basis upon which an alternative macro-economic framework can be designed the Group retains the Aging Working Group macro-economic framework for its modelling.

02. The 2010 Pensions Working Group recognises that assumptions over a 50 year period are tenuous at best thus recommends that the Government should not consider to rectify today the projection outcomes as they appear in 2060 but should continue to adopt a calibrated reform of the pensions system over a five year period as is now mandated by the Social Security Act and in doing so adopt incremental measures that will have a long term impact towards the adequacy, sustainability and solidarity of the pension system.

03. The 2010 Pensions Working Group strongly emphasises that the proposed incremental approach to pension reform should not be interpreted to mean that no reform is required or that there is no urgency in the need for continued reform: key decisions need to be considered and taken and timeframes set for a number of overarching reforms that go beyond the parametric changes to the First Pension introduced in 2007.

04. Whilst the introduction of the Child Rearing Credit measure was a positive pro-natal policy design measure within the First Pension system, its desired effect with regards to women who have to interrupt their career due to child rearing was neutralised by the increase in the contributory period which rendered it even harder for a female to achieve the full contribution period. To compensate for this neutralising effect the 2010 Pensions Working Group proposes that the Government should consider amending the Child Rearing Credit and calibrating it on the basis of a pro-natal bias with the said amendment to take effect retro-actively as at 1st January 2011:

- A first child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of two (2) years or six (6) years as the case may be subject to the condition that the beneficiary returns to employment for a period of two (2) years.

- A second child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of three (3) years or eight (8) years as the case may be subject to the condition that the beneficiary returns to employment for a period of three (3) years.

- A third or further child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of five (5) years or ten (10) years as the case may be subject to the condition that the beneficiary returns to employment for a period of five (5) years.

05. The 2010 Pensions Working Group, with the benefit of hindsight, is also recognisant that the Child Rearing Credit as introduced in the 2007 reform negatively affected parents classified within the transitional cohort and therefore recommends that parents within this age cohort are provided backdated to 1st January 2007 with:

- a one (1) year pension credit for each child born under six years of age; or

- a two (2) year pension credit for each child born suffering from a serious disability under the age of ten

subject to the condition that the parent will return to work for an equivalent time period.

06. Whilst recent data seems to show that the decline of the fertility rate has plateaued this does not provide for the demographic revitalisation required to counter Malta's aging and shrinking population – and in doing so minimising the demographic risks to the PAYG First Pension – and the Government should consider appointing a Task Force to present to it at the earliest possible recommendations on a holistic pro-natal policy framework that balances the responsibility of a raising a family with the aspiration to remain an active participant in the labour market.

07. The 2010 Pensions Working Group is of the considered opinion that the new medical assessment process for social benefits has had a positive impact and future measures should be directed to strengthen it.

08. The 2010 Pensions Working Group recommends that the Government should, as a further phase of the reform of the invalidity and disability pension system, give serious consideration to transform the paradigm from one that bases invalidity as a result of a condition of the said disability to one that determines the degree of the invalidity to the person's ability to function; together with the holistic underlying support (re-skilling, psychological support, etc) required to achieve such a paradigm shift.

09. The 2010 Pensions Working Group recommends that, should the Government consider a reform as proposed in Recommendation 08, the pension awarded should change to one which reflects the degree of the functional incapacity whilst allowing a person to continue to participate in the labour market to earn income as appropriate.

10. The 2010 Pensions Working Group recommends that the Government should continue to strengthen community care support infrastructure for the sick, disabled and elderly persons so

as to alleviate the pressure on individuals, particularly females, from the responsibility of care and, consequently, enables them to take on paid employment.

11. The 2010 Pensions Working Group recommends that the Government should consider seeking ways to render childcare facilities in Malta more affordable as well as work with Local Councils so that such programmes are introduced on a locality level to increase accessibility.

12. The 2010 Pensions Working Group recommends that Government should study the concern raised by the constituted bodies representing women with regards to the increased need for Before and After School Care Programmes as the absence of such a support mechanism is seen as an obstacle to increased female participation in the labour market.

13. The 2010 Pensions Working Group, whilst acknowledging that Government has been at the forefront leading by example with regards the introduction of flexi-time and tele-working the efforts in this regard, should be complemented by the professional development of public and private sector management with regards to the application and promulgation of such new work practices.

14. The 2010 Pensions Working Group recommends that measures are introduced to incentivise females (and males) to join the formal economy and decrease participation in the black market economy, both to boost the economic growth of the country, as well as to secure adequate pensions for all in the future.

15. The 2010 Pensions Working Group proposes that a national educational campaign is created which is aimed particularly at males / fathers to raise awareness on a more egalitarian family and social model, as well as encourage the social partners to promote more equal sharing of family and / or caring responsibilities. In addition, the egalitarian family and social model should be instilled early on in childhood through the inclusion of this subject in the school curriculum.

16. The 2010 Pensions Working Group proposes that the Government should consider introducing on-going assessment of policy measures introduced to increase female participation in the labour market, so as to gauge their level of success, identify lessons to be learnt, etc as a means to inform future policy making, introduce calibration where necessary and improve future scheme.

17. The 2010 Pensions Working Group recommends that the Government should consider assuming an active affirmative policy to retain beyond the official retirement age employees who can add value and, therefore, acts as the trail blazer in this regard.

18. The 2010 Pensions Working Group recommends that the Government should consider to reform in 2011 the provisions in the Social Security Act relating to part-time work 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 on an atypical basis – that is, irrespective of the number of employers the person is engaged with.

19. The 2010 Pensions Working Group whilst noting that Malta should continue to invest heavily in education to build its indigenous human capital recommends that the Government should consider a targeted immigration and residency policy to narrow skills deficits and inadequate labour supply that is or may constrain the economy from growing further and where short run solutions on the labour domestic market are unlikely to give the desired results – and in doing so increasing the contributory base of the First Pension.

20. The 2010 Pensions Working Group recommends that the Government should consider linking the official retirement age of the First Pension system to a retirement age - longevity index.

21. The 2010 Pensions Working Group recommends that the Government should consider indexing the 61 years of age opt out rule to a retirement age – longevity index grafted onto the

First Pension system so that the disincentive period increases in equal relativity to increases in the official retirement age.

22. The 2010 Pensions Working Group recommends that the Government in 2012 should consider replacing the Survivor's Pension by the eligible full pension to be provided to the surviving female spouse on the grounds that this is gender discriminatory given that the surviving female spouse too would have contributed to the said pension through her role as a home carer during her lifetime.

23. The 2010 Pensions Working Group recommends that the Government in 2011 should consider amending the Social Security Act to allow a widow who is aged 22 years and over when her spouse dies prior to retirement age to work and earn income from gainful activity that exceeds the yearly average of the National Minimum Wage without forfeiting her right to a widow's pension in order to incentivise her to remain active in or re-enter the labour market.

24. The 2010 Pensions Working Group recommends that the Government in 2011 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.

25. A Notional Defined Contribution First Pension system has in built features that allows it to self-adjust vis-a-vis its financial sustainability and longevity; as well as awarding higher replacement rates for persons who remain active in the labour market. The 2010 Pension Working Group is of the considered opinion that the Minister of Pensions should consider appointing a Working Group to assess by 2013 the:

- possibility of transforming the Two-Third Pension into a Notional Defined Contribution First Pension,
- short to long term impact of such a reform on the adequacy, sustainability and solidarity of the pension system,
- ability to migrate from a Two-Thirds Pension to Normal Defined Contribution First Pension; and
- implementation issues that would have to be addressed.

26. The 2010 Pensions Working Group recommends that the Government should consider introducing a Mandatory Second Pension directed at persons who are aged 45 years and younger at the time when it is introduced.

27. The 2010 Pensions Working Group recommends that the Government should consider inviting the Opposition and relevant representatives of both employers and employees to participate in the design and implementation of a Mandatory Second Pension. Strategic and important decisions have to be taken with regards to matters such as the size of contributions; the sources of financing for these contributions and the phasing in of the framework, et al. To the extent possible the introduction of a Mandatory Second Pension should be based on a national consensus.

28. The introduction of a Mandatory Second Pension will not happen overnight and the 2010 Pensions Working Group recommends that this time is maximised by Government and the representatives of employees and employers so that both employees and employers are prepared as best as possible for the introduction of a Mandatory Second Pension.

29. The 2010 Pensions Working Group is of the considered opinion that whilst the person prudent principle and the qualitative and quantitative investment criteria established in the IOPS Directive suffice with regards to a voluntary ORP scheme or a Third Pension where a conscious decision to voluntarily invest in such an instrument is made, they do not suffice in providing the necessary level of protection for a Mandatory Second Pension framework where an individual is *forced* to save in such a scheme.

30. The 2010 Pensions Working Group recommends that the introduction of a Mandatory Second Pension should be supported by a Default Fund framework based on a lifecycle investment strategy in which people who fail or are unwilling to make an investment choice are de facto enrolled in and that the Government should consider inviting, under the direction of ministerial policy orientation, the Malta Financial Services Authority to present recommendations on the most appropriate framework for the design and grafting of such a Default Fund onto the Mandatory Second Pension Framework.

31. The 2010 Pensions Working Group recommends that Ministry for Pensions and the Malta Financial Services Authority should carry out a review by the earliest possible on the mechanism that Malta is to introduce to ensure that the most optimal administrative cost structure for the Mandatory Second Pension is introduced as otherwise the real danger exists that pension returns would be significantly eroded. Such a review would evaluate, amongst others the:

    - introduction of a fee capping structure; or

    - establishment of the Department of Inland Revenue to act as a clearing house.

32. The 2010 Pensions Working Group recommends that Government should consider introducing the Third Pension framework as early as possible in 2011 in order to provide the appropriate vehicle for persons to save for their pension voluntary should they wish to do so.

33. Given that a Third Pension framework will be introduced prior to a Mandatory Second Pension the 2010 Pensions Working Group considers it to be of strategic importance that a Third Pillar framework is designed in such a way to facilitate persons who invest in it to be able to migrate into the Mandatory Second Pension as otherwise people may decide against investing in a Third Pension if they fear that they would have to pay an addition saving contribution once the Mandatory Second Pension is introduced.

34. The 2010 Pensions Working Group recommends that given that Malta is yet to establish instruments for saving for one's retirement let alone building a culture for saving for one's retirement there is merit that in the building of such a culture the Government may wish to consider putting together a tax incentives framework to spur people to invest in a Third Pension.

35. The 2010 Pensions Working Group recommends that the Government should consider introducing a fiscal instrument directed to incentivise persons to invest in savings for their retirement through a Third Pension that is designed on the following basis that the:

    - fiscal instrument is in the form of a tax deduction

    - contribution is tax exempt;

    - maturity value is tax exempt;

    - annuity or income received is taxable.

36. The 2010 Pensions Working Group recommends that the Government should consider reviewing the Income Tax Act with regards to provisions related to private pensions and to harmonise such provisions with other appropriate related legislation.

37. The 2010 Pensions Working Group is of the considered opinion that an opportunity exists to fast track the introduction of pension savings accounts by incentivising the conversion of existing financial products on maturity into locked pensions savings and recommends that the Government should consider working with appropriate stakeholder to devise a way forward in this regard by 2012.

38. The 2010 Pensions Working Group recommends that the Ministry for Pensions and the Malta Financial Services Authority should consider studying the introduction of a regulated home equity release market directed to allow a person to boost his or her retirement income without the need to sell his or her property during his and his spouse's lifetime – which study should amongst others assess:

- whether a specific legal framework would be required and whether amendment to the law of succession is required.

- the design of a regulatory framework that would ensure the proper conduct of business by entities providing such products as well as securing robust protection of consumers.

- the introduction of appropriate governance mechanisms to prevent concentrated ownership of property by a limited number of private sector operators.

- the risks and mitigation thereof of persons adopting home ownership products upon retirement.

- the implication of equity release products in relation to taxation and succession duties.

39. The 2010 Pensions Working Group recommends that the Government should consider to reform the Children's Allowance benefits scheme so that a parent on a voluntary basis may request the Department of Social Security to open a Child Pension Account from which there will no withdrawal, will become the child's property at the age of 18, the balance will automatically be transferred to a pension scheme of the owner's choice.

40 The 2010 Pensions Working Group recommends that, in order to incentivise an accelerated accumulation of the capital within a Child Pension Account, the Government should consider studying the impact of a fiscal incentive scheme that would provide a tax deduction for contributions to a certain limit made by the parents or direct relatives of the child into the said Pensions Account.

41. The 2010 Pensions Working Group recommends that the Government should task the National Statistics Office, the Ministry for Pensions and the Malta Financial Service Authority to carry out a specifically designed survey that will provide a baseline and acts as the starting point for assessing adult financial literacy in Malta.

42. The 2010 Pensions Working Group recommends that that the Government should consider establishing in 2011 a permanent Task Force on Financial Literacy that is assigned the terms of reference to design and implement a financial literacy strategy directed to help people achieve the following:

- be able to make financial decisions related to home ownership, saving, preparing for retirement, et al.

- attain a better level of understanding with regards to financial services products that they own, may yet purchase and in preparation for the introduction of a Mandatory Second Pension.

- attain a level of knowledge that allows for the placement of smart attitudes and habits such as asking appropriate questions prior to making an investment choice.

- recognise mis-selling and other unethical behaviour as well as the ability to interpret the fine line details that accompany a financial services product.

- understand the basics of how the market operates and the principles of risk and reward that may result when making financial investment decisions.

- understand how inflation, interest rates and fees associated with saving, investment and debt work.

43. The 2010 Pensions Working Group recommends that the newly established Task Force, if the Recommendation 41 is adopted by Government, should enter into discussions with the Directorate for Education Services to establish within the education curriculum the fundamental basics of financial management and literacy and to amend the Curriculum of Personal and Social Development subject at both the primary and secondary level of education to include modules on financial literacy.

44. The 2010 Pensions Working Group recommends that the newly established Task Force, if the Recommendation is adopted by Government, should enter into discussions with:

    - the Employment and Training Corporation to introduce financial literacy training programmes for persons in employment; and

    - appropriate constituted bodies to assist employers to introduce seminars on financial literacy to their staff.

45. The New Pensions Working Group recommends that the Government should consider strengthening the Department of Social Security by setting up of a Strategic Pensions Unit that would act as a resourced and sustained vehicle that ensures continued organised review and calibration of the Malta's pensions system.

Finally, the Working Group underlines the important need for Government to consider the setting up of Strategic Pensions Unit within the Ministry for Pensions.

Strategic work relating to pension policy design and review cannot start – stop with every five year review: it must be on-going. As shown in this Report and the supporting Supplementary Papers this is a complex policy domain that transcends and is impacted by actions taken in other policy sectors.

Additionally, as further shown by this Report, there is considerable important work that requires to be undertaken both in terms of further study as well as in supporting the implementation process once Government reaches its position on the recommendations presented for its consideration. The Strategic Pensions Unit should not only be the critical link between each review and the next, but should also be the underlying coordinating entity on all matters relating to pensions policy design and research within which the accruing body of knowledge and experience is institutionalised.

The need to build and sustain capacity and dedicated expertise is deemed to be a fundamental necessity.

**Table of Contents**

## List of Tables

## List of Charts

## Glossary

| | |
|---|---|
| APF | Autonomous Pension Fund |
| APRR | Average Pension Replacement Rate |
| AWG | Ageing Working Group |
| CEDEFOP | European Centre for Development of Vocational Training |
| CSCP | Cabinet Committee for Social Policy |
| DB | Defined Benefits Pension Scheme |
| DC | Defined Contribution Pension Scheme |
| DSS | Department for Social Policy |
| EEA | European Economic Area |
| EC | European Commission |
| ECOFIN | EU Economic and Financial Affairs |
| EPD | Economic Policy Division |
| EU | European Union |
| EUROPOP | Demographic Projection undertaken by EUROSTAT |
| EUROSTAT | European Union Statistics Agency |
| HBS | Household Budgetary Survey |
| IMF | International Monitoring Fund |
| GDP | Gross Development Programme |
| GNMP | Guaranteed National Minimum Pension Income |
| IRD | Inland Revenue Department |
| MCESD | Malta Council for Economic and Social Development |
| MFEI | Ministry of Finance, Economy and Investments |
| MFSA | Malta Financial Services Authority |
| MPI | Maximum Pensionable Income |
| MSP | Ministry for Social Policy |
| NDC | Normal Defined Contribution Pension System |
| NSO | National Statistics Office |
| OECD | Organisation for Economic Co-operation and Development |

| | |
|---|---|
| OPR | Occupational Retirement Pension |
| PAYG | Pay As You Go Pension System |
| PROST | Pensions Reform Simulation Tools Kit |
| PWG | Pensions Working Group set by the Prime Minister in June 2004 |
| PWG2010 | 2010 Pensions Working Group as reconstituted in February 2010 by the Minister for Pensions |
| SSA | Social Security Act |
| WB | World Bank |
| WG | 2008 Working Group on Second and Third Pillar Pensions |
| WS | Working Group set by Ministry for Social Policy |

## 01.1 Terms of Reference of the 2010 Pensions Working Group

In August 2008 the Minister for Social Policy (MSP) reconvened the Pensions Working Group. The newly formed Working Group (WG) was given the following terms of reference:

- To review as appropriate and submit recommendations to MSP on the design of a legislative framework for the introduction of a Second and Third Pension.
- To review the recommendations presented in the White Paper and Final Report presented to Government by the then Pensions Working Group (PWG) in 2005 in relation to private pensions.
- To propose recommendations for the introduction of a Second Pension framework.
- To propose recommendations for the introduction of a Third Pension framework.

The WG was constituted of senior representatives of MSP, the Department of Social Security (DSS), the Economic Policy Division (EPD), and the Malta Financial Services Authority (MFSA). The Report prepared by the WG was presented to the Minister for Social Policy in December 2009.

In February 2010, following the Cabinet re-shuffle the new Minister for Pensions constituted a new Pensions Working Group (PWG2010) with the following terms of reference:

- to use the December 2009 Report as a basis to meet the obligation placed by Article 64B of the Social Security Act (SSA) on the Government to lay on the Table of the House a report that reviews Part V of the said Act together with recommendations if any, with a view of achieving further adequacy, sustainability and social responsibility.
- that this report is to be presented to the House of Representatives by not later than the 31$^{st}$ December 2010.

## 01.2 The Constitution of the 2010 Pensions Working Group

The PWG2010 is constituted as follows:

| | |
|---|---|
| Chairperson | David Spiteri Gingell |
| Members | Joseph Rapa<br>Director General, Economic Policy Division, Ministry of Finance, Economy and Investment |
| | Joe Camilleri<br>Director General, Department of Social Security, Ministry for Education, Employment and the Family |
| | Mark Borg<br>Director General, Budget Office, Ministry of Finance, Economy and Investment |

Mark Musu
Director for Strategic Development and International Relations, Department of Social Security, Ministry for Education, Employment and the Family

Frankie Micallef
Director for Social Benefits, Department of Social Security, Ministry for Education, Employment and the Family

Godwin Mifsud
Senior Economist, Economic Policy Division, Ministry of Finance, Economy and Investment

Donna Micallef
Policy Manager, Pensions, Ministry for Education, Employment and the Family.

## 01.3 The Methodology Applied by the 2010 Pensions Working Group

In preparing this report, the PWG2010 applied the following methodology:

01. Maintained a close relationship with the Inland Revenue Division (IRD) with regards to the design of a fiscal incentive instrument to spur uptake of a voluntary Third Pension.

02. Carried out a broad consultation process with constituted bodies, Non Government Organisations and other interested stakeholders. **Supplementary Paper Number 01** presents a synthesis of the views put forward to the PWG2010 by the respective stakeholders.

03. Contracted the National Statistics Office (NSO) to carry out a survey to allow the PWG2010 to obtain a good understanding of the public perceptions relating to the state of play with regards to pensions and pensions reform. **Supplementary Paper Number 02** presents the survey methodology and a synthesis of the findings.

04. Maintained a close relationship with MFSA with regards to discussions on the governing framework relating to the Second Pension and the Third Pension respectively. **Supplementary Paper Number 03** presents a discussion on key principles relating to a Mandatory Second Pension.

05. Maintained a close relationship with MFSA with regards to the leveraging of investment in Home Ownership into income during retirement. **Supplementary Paper No 04** presents a discussion in this regard.

06. Contracted the World Bank (WB) to carry out an Actuarial Study of the First Pension. Part I of **Supplementary Paper Number 05** presents the findings of the Actuarial Study.

07. Contracted the WB to update the Pensions Reform Options Simulation Tool Kit (PROST) to model projections and scenarios for reform on the most recent data, and to present recommendations for the consideration of the PWG2010. Part II of Supplementary Paper Number 05 presents the PROST analysis and recommendations.

08. Contracted the WB to draw up a review of a Second Pension and a Third Pension frameworks respectively and to forward recommendations for the consideration of the PWG2010. Part III of Supplementary Paper Number 05 presents the WB's study in this regard.

09. Undertook a visit to the Swedish Pensions Authority and the Agency responsible for the AP7 Default Fund to discuss the reforms that led to the introduction of the Notional Defined

Contribution (NDC) pension scheme, the setting up of the Pensions Authority as a Clearing House, and the setting up of the AP7 Default Fund.

10. Built on the work carried out by the PWG between June 2004 and December 2007 as well as that carried out by the WG between August 2008 and December 2009.

## 01.4 Acknowledgements

The PWG2010 thanks all persons that assisted it through the provision of information, discussion of issues and specific studies carried out on its behalf. The PWG2010 specifically thanks the staff of the EPD within MFEI, of the Policy Unit of MFSA, and of the NSO.

The conclusions of the Report are, however, the views of the PWG2010.

## 02.1 The White Paper 'Pensions: Adequate and Sustainable' and the Final Report Presented by the Pensions Working Group

The need to reform the pension framework was felt by successive Administrations which led to the setting up of the Camilleri Commission and the Galdes Commission in December 1997 and June 1999 respectively. Subsequent to this, the Ministry of Finance in October 2003 invited the WB to carry out a study on the viability of a number of principles – chiefly a[1]:

(i) lowering of the contribution rate - directed to separate pensions from other benefits. Since the original social security contribution was expected to cover a wide range of social benefits, the health contribution has to be separated and ring-fenced. Contribution rates for employees were proposed to be at 8% instead of 10% with Government to contribute 9% in place of 10%. The self-employed were proposed to contribute only 12% instead of 15% with Government 6% instead of 7.5%.

(ii) gradual increase in the retirement age from 61 to 65 years for both genders to be fully phased in by 2015.

(iii) gradual change in the minimum years of contribution required for the 2/3 pension to 35 years from 30 years to be phased in by 2015.

(iv) gradual change in the averaging period used for calculating the value of the pension to the average of the last 10 years from average of the best 3 in the last 10 years, to be fully phased in by 2015.

(v) change in the indexation of the pension after retirement from full indexation to wage growth to revising pensions every 5 years by a percentage of the increase in the average salary paid to government employees.

In March 2004, the WB submitted its report. Responsibility for the review of the assessment of the WB report was placed under the newly constituted Cabinet Committee for Social Policy (CCSP). The CCSP recommended that the Government should set up a PWG with the brief to ensure that the Government would be in a position to issue a White Paper for public consultation on the day when the 2005 National Budget would be discussed at the House of Representatives.

The PWG was constituted on 1st June 2004. The White Paper was subsequently issued by Government for public consultation as planned. In designing the recommendations presented in the White Paper, the PWG was guided by the Value System established for pensions reform and introduced by the European Union (EU) at the 2001 Gothenburg Council.

Following a comprehensive consultation process the PWG presented its Final Report to the Government on 30th June 2005. The final recommendations of the PWG can be catagorised as follows:

01. An incremental approach to reform with measures directed in different degrees to the pre-identified cohorts. These were identified as follows:

    - Switchers Group: Persons who would be placed on the new pension system. These were identified to be persons who would be 45 years of age or younger on the day the reforms are introduced.

[1] 4.02, The Maltese Pensions System: An Analysis of the Current System and Options for Reform, World Bank, March 2004

- Transitional Group: Persons who would be placed on a transitional mix of new reforms and outgoing parameters of the then existing pension system – with the bias of the transitional process edging towards the new reforms if the person's age is closer to the 45 years of age set for the switchers' group. Persons in the Transitional Group were identified to be between 54 years of age and 46 years of age on the date the reforms are introduced.

- Exempt Group: Persons who would not be affected with any of the reform measures proposed. Persons in the Exempt Group were identified to be 55 years of age and over on the date the reforms are introduced.

02. The introduction of a Minimum Pension Guarantee to prevent social exclusion which was proposed to be indexed at 50% of Average Wage.

03. The introduction of parametric changes to the First Pension in order to strengthen both the adequacy and sustainability of the First Pension framework. Recommendations in this regard included the raising of the retirement age; increasing the contributions' accumulation period, changing the formula for the calculation of the pensionable income, introduction of credits for child rearing, etc.

04. The introduction of a Second Pension to be introduced on a voluntary basis with effect from 1st January 2006 supported by a 1% Employee and 1% Employer carve out from Class I and Class II contributions respectively with the Government to establish the Second Pension as a Mandatory Pension Scheme by 2010 in the event that an assessment to be carried out in 2009 showed that conditions were such that necessitated a mandatory introduction.

    The recommendation to introduce a Mandatory Second Pension was directed to diversify the demographic risk that is intrinsic to a PAYG pension system as well as to ensure the a person during his or her employment career builds sufficient savings that will reduce the quality of life gap that may arise as a result of an adequate pension which will never suffice to provide a level of income equal to that earned whilst in employment.

05. The introduction of a Third Pension which would be voluntary and would provide an individual with the choice and opportunity to save further for his or her retirement to secure a larger pension income than would be provided by a combined First Pension and Mandatory Second Pension pensionable income. The PWG proposed that Government should consider the introduction of fiscal incentives to stimulate increased savings under a voluntary Third Pension.

## 02.2 The Reforms Adopted by the Government

On 1st March 2006, the Prime Minister together with the Chairman of the CCSP and the Minister responsible for pensions placed in the public domain the reforms that it has to present to the House of Representatives for debate. It was further stated that the Government, through the Minister for Pensions, would continue to consult as appropriate with stakeholders until the proposed amendments to the Social Security Act (SSA) are legislated by the House.

The debate on the Second Reading of the proposed amendments to the SSA initiated in July of that year and was finalised in November of the said year. The amendments to the SSA were brought into force by Act No XIX of 2006 on 7th December 2006.

The following are the salient elements of the Pensions Reform introduced with effect as from 1st January 2007:

### 02.2.1 Pension Age

Prior to the reform pension age in Malta was **sixty** (60) years for women and **sixty one** (61) years for men who retire from gainful activity (where-in 'gainful activity' for persons over pension age is deemed to be activity through which earnings of more than the National Minimum Wage are derived, where-in in 2007 the National Minimum Wage stood at €138.93 per week).

The new provisions introduced a gradual increase in pension age as follows:

- In the case of a person born on or before the 31st December 1951, the pension age is to remain as is currently, that is for men pension age shall be sixty one (61) years of age whilst for women pension age shall be sixty (60) years of age; (Note: Women in such an age bracket were given the option to retire at sixty one (61) years of age and the employer is not able to terminate her employment if such a women opts to work until sixty one (61) years of age).

- In the case of a person born during the calendar years 1952 to 1955, pension age is raised to sixty two (62) years of age.

- In the case of a person born during the calendar years 1956 to 1958, pension age is raised to sixty three (63) years of age.

- In the case of a person born during the calendar years 1959 to 1961, pension age is raised to sixty four (64) years of age.

- In the case of a person born on or after the 1st of January 1962 pension age is raised to sixty five (65) years of age.

### 02.2.2 Removal of Disqualification from a Pension in Respect of Retirement

Persons born on or before the 31st December 1961 benefited from the provisions of the legislation as such persons, on reaching pension age, would no longer forfeit their right to such pension even if they continue to work and earn income from gainful activity that exceeds the yearly average of the National Minimum Wage.

### 02.2.3 Opt-out for Earlier Retirement

The reform provided for an early retirement opt-out clause. This opt-out clause provides that a person who has attained the age of sixty one (61) years, but has not yet attained the applicable pension age, may retire after attaining sixty one (61) years of age on the condition that such person has accumulated since his or her 18th birthday, a total of:

- 2,080 paid or credited contributions if born on or after the 1st January 1962; or

- 1,820 paid or credited contributions in the case of a person born during calendar years 1952 to 1961.

This reform instrument was introduced to allow persons who are employed in manual or stressful employment and where continued employment due to a mandatory increase in the retirement age would not be physically or mentally possible. Nevertheless, in order to secure that early 'opt-out' is truly carried out by persons who genuinely cannot continue to work beyond 61 years of age a condition was introduced that curtailed the right of a person retiring under this opt-out clause to be able to carry out any gainful activity following such retirement. After attaining sixty five (65) years of age, gainful activity will not affect such pensioner's entitlement.

### 02.2.4 Calculation of Contribution Average of the Two-Thirds Pension

The full rate of the two-thirds pension would be equal to two-thirds (2/3rds) of the pensionable income of a person who, following his or her eighteenth (18th) birthday has paid or been credited with a yearly average of 50 social security contributions over a period of:

- Thirty (30) years in the case of a person born on or before the 31st December 1951.
- Thirty five (35) years for a person born during the calendar years 1952 to 1961.
- Forty (40) years in the case of a person born on or after the 1st January 1962.

In the case of persons born on or before the 31st December 1961, the contribution average calculation as indicated above would continue to be carried out under the current regime. This means that for each person two periods of contribution averages will be considered:

- The last ten (10) complete calendar years prior to a person's retirement.
- Any other twenty (20) or twenty five (25) contribution years, as applicable in the case, starting from the first day of the contribution years in which a person reaches the age of eighteen (18) and ending on the last day of the complete calendar years prior to the beginning of the last ten (10) calendar years prior to retirement.

The average of the two average periods as indicated above, determines the pension ratio.

With respect to persons born on or after the 1st January 1962, the contribution average assessment will be carried out on one period which will be made up of any forty (40) years from the first day of the contribution years in which the person reaches the age of eighteen (18) years of age and ending on the last complete contribution years prior to retirement.

### 02.2.5 Calculation of the Applicable Pensionable Income

Following the Reform, in the case of persons born on or before the 31st December 1951, there are no changes to the current system to calculate a pensionable income.

In the case of a person born during the calendar years 1952 to 1955 the calculation of the pensionable income is as follows:

- In the case of a person deemed to be an employed person, the pensionable income is assessed as the average of the best three (3) consecutive calendar years out of the last eleven (11) calendar years' basic wages.
- In the case of a person deemed to be a self employed or self occupied person, the pensionable income is assessed as the average of the best ten (10) calendar years' net income/net earnings of the self-employed/self-occupied respectively during the last eleven (11) calendar years prior to retirement.

In the case of a person born during the calendar years 1956 to 1958 the calculation of the pensionable income will become:

- In the case of a person deemed to be an employed person, the pensionable income is assessed as the average of the best three (3) consecutive calendar years out of the last twelve (12) calendar years' basic wages.
- In the case of a person deemed to be a self employed or self occupied person, the pensionable income is assessed as the average of the best ten (10) calendar years' net income/net earnings of the self-employed/self-occupied respectively during the last twelve (12) calendar years prior to retirement.

In the case of a person born during the calendar years 1959 to 1961 the calculation of the pensionable income is now:

- In the case of a person deemed to be an employed person, the pensionable income is assessed as the average of the best three (3) consecutive calendar years out of the last thirteen (13) calendar years' basic wages.

- In the case of a person deemed to be a self employed or self occupied person, the pensionable income is assessed as the average of the best ten (10) calendar years' net income/net earnings of the self-employed/self-occupied respectively during the last thirteen (13) calendar years prior to retirement.

In the case of a person born on or after the 1st January 1962, there no longer is a distinction between employed, self-employed or self-occupied with respect to the calculation of a pensionable income.

For persons born on or after the 1st January 1962, the pensionable income is the yearly average of the basic wage / salary / net income / net earnings as the case may be, during the best ten (10) calendar years within the last forty (40) calendar years prior to a person's retirement.

### 02.2.6 The Maximum Pensionable Income

The reform effected the following changes to the Maximum Pensionable Income (MPI) on which the 2/3 First Pension is calculated. The MPI of a person:

- Born on or after the 31st December 1961 is –
    - €16,424 (2007) increased by the Cost of Living awarded generally by Government up to 2010.
    - Between 2011 up to 2014, the MPI will increase in three (3) tranches up to €20,970.
    - After 2014, the MPI will be indexed to a mechanism that is constituted of 70% wages and 30% inflation.
- Born during calendar years 1952 and 1961 is –
    - €16,424 (2007) increased by the Cost of Living awarded generally by Government up to a maximum of €20,970.
- Born on or before the 31st December 1951 is –
    - €16,424 (2007) increased by the Cost of Living awarded generally by Government up to a maximum of €17,475.

### 02.2.7 The Guaranteed National Minimum Pension

Effective from the 1st January 2011, changes are envisaged to the National Minimum Pension, which currently stands at 4/5ths of the National Minimum Wage for a married couple and 2/3rds of the National Minimum Wage for any other person.

A person born on or after the 1st January 1962 shall in no case receive a social security pension (inclusive of any service pension where applicable) that is less than the rate of the Guaranteed National Minimum Pension (GNMP).

The GNMP rate will be equivalent to 60% of the National Median Income. The exact rate shall be determined and published by the National Statistics Office and published in the Gazette. In any case, the rate of the GNMP can never be less than that declared for the preceding years.

### 02.2.8 Crediting of Contribution for Parents for Child Rearing

Effective from the 1st of January 2007, credits of social security contributions are awarded to parents within the Switchers group – that is born on or after 31st December 1961. The maximum number of credits that may be awarded in such a case is two (2) years for each and every child or in the case of a child suffering from a serious disability the period of two (2) years is extended to four (4) years.

The applicable period of credits may be shared between both parents but can never exceed the total number of credits assigned.

The basic conditions for entitlement are that the parent:

- has the legal care and custody of a child who is less than 6 years of age (or 10 years of age in the case of a child suffering from a serious disability); and

- has since returned to gainful activities for a minimum number of years equivalent to the period credited.

The above is also applicable to adoptive parents.

### 02.2.9 Pension System Review and the Introduction of the Second and Third Pension respectively

A legal provision was introduced whereby the Minister responsible for pensions will, within intervals not exceeding five years, submit a report to Parliament, in which a review of the Pensions System is carried out. This report is also to include recommendations for achieving further adequacy, sustainability and social solidarity.

The reform also provided the legal virus for the Minister responsible for pension, in concurrence with the Minister responsible for finance to make regulations that would see the introduction of a Mandatory Second Pension and a Voluntary Third Pension scheme respectively.

# Chapter 03: Calibrating the Data and Macro-economic Modelling Assumptions for the 2010 Pensions Review

## 03.1 The Macro-Economic and Demographic Assumptions by the Pensions Working Group

The White Paper and, subsequently, the Final Report of the then PWG was benchmarked against the World Bank report presented to Government in March 2004. The White Paper provides a synthesis of the key findings of the World Bank and the recommendations proposed.

It is to be noted, therefore, that the modelling which the PWG had carried out both when drawing up the White Paper and the Final Report – in both circumstances with the assistance of the World Bank – was based on the following:

01. The data in PROST on which the World Bank carried out its modelling to ensure that a common baseline was secured between the modelling by the World Bank and the PWG.

02. The data baseline was established at 2002. Unless otherwise specifically stated in the relevant appendices of both the White Paper and the Final Report this data was retained.

## 03.2 The Macro-Economic and Demographic Assumptions of the Aging Working Group of the Economic Policy Committee of the EU Economic and Financial Affairs Council

Subsequent to parametric reforms discussed in the previous Chapter, the work of the PWG was completed. Macro-economic modelling with regards to pensions was thereafter carried out by the EPD of the MFEI. In November 2008 the EPD, with the assistance of experts from the WB, carried out economic modelling on pensions for the period 2008 - 2060 for the Ageing Working Group (AWG) of the Economic Policy Committee (EPC) of the EU Economic and Financial Affairs Council (ECOFIN).

In 2006, the ECOFIN Council gave the EPC the mandate to update with the European Commission (DG, ECFIN) its common exercise of age-related expenditure projections on the basis of a new population projection by Eurostat. On the basis of the 2008 population projection (EUROPOP2008) produced by Eurostat, the AWG of the EPC agreed a common set of assumptions and methodologies to make projections for exogenous macro-economic variables: the labour force (participation, employment and unemployment rates), labour productivity and the real interest rate. The Gross Domestic Product (GPD) was calculated combining these assumptions.

It is to be noted that these macro-economic assumptions differ significantly from those applied by the PWG. It is pertinent to note, that given the significant difference in the assumptions that governed the work of the then PWG between 2004 and 2007 with those that govern the modelling carried out by the PWG2010 for this Report the result is that is not possible to compare these results with those of 2005 given that they are respectively based on different baselines.

Comparative assessment in terms of behaviour of the reform model over time is, therefore, *not* possible as the assumptions that shape the outcome of the modelling are now based on completely separate methodologies.

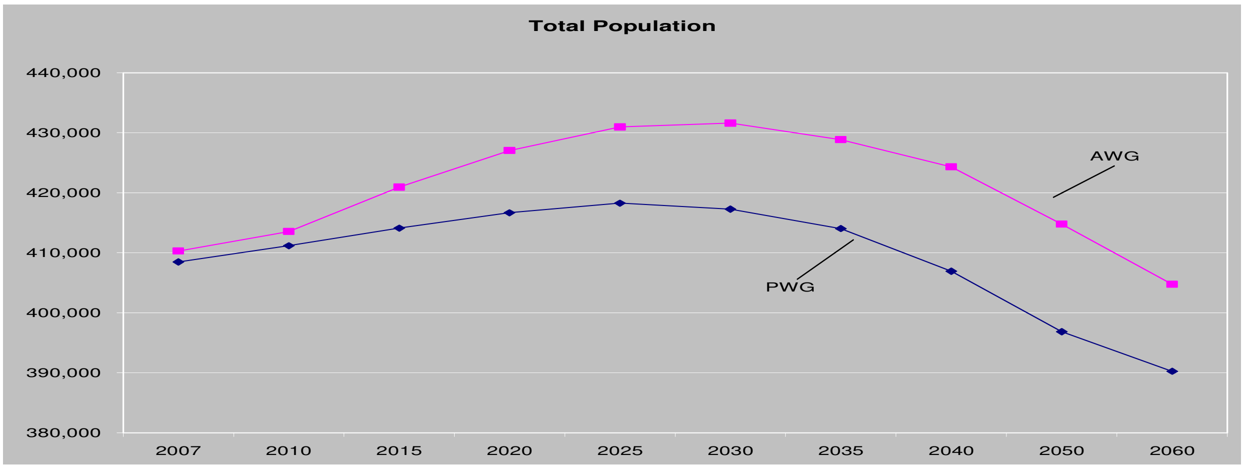
Be that as it may, given the significant differences between the assumptions applied by the then PWG and the assumptions of the AWG on which the PWG2010 has carried out its modelling for this Report extended discussion in this regard is necessary.

### 03.2.1 Total Population

**Chart 01** below compares the assumptions used by the PWG and the AWG in relation to Population. The PWG applied demographic data that was used by the WB in its report of March 2004. This data was obtained from the WB through the Malta Council for Economic and Social Development (MCESD). This data is consistent with the projections made by the NSO. The AWG applied the EUROPOP 2008 population projection.

As can be seen from the **Chart 01** below, the Maltese population growth is smaller under the PWG assumption.

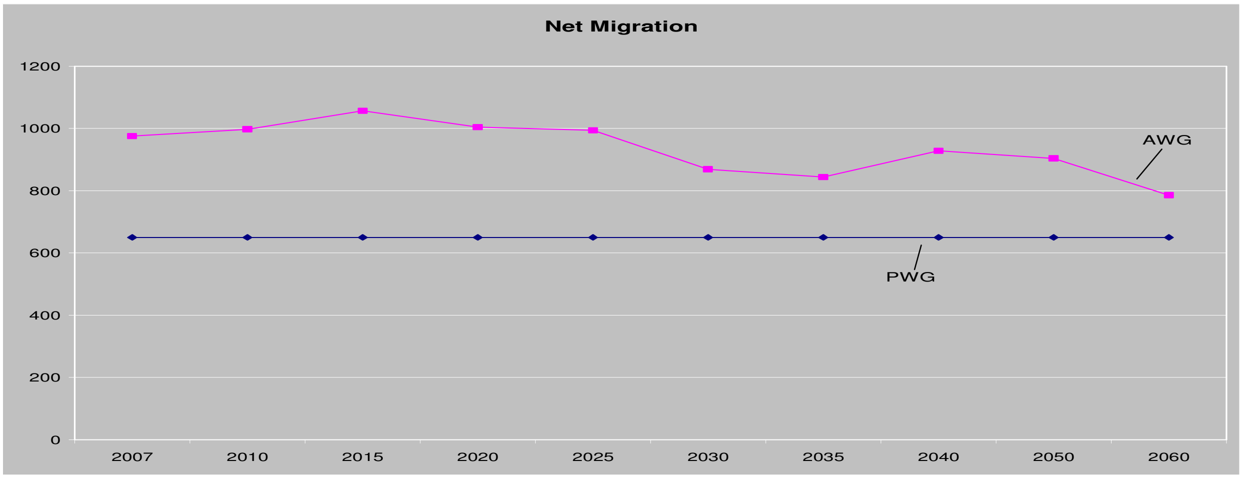
**Chart 01: Total Population**




This is primarily the result of a lower net migration rate in the PWG model. The PWG assumed that the work force would annually increase by the addition of 500 immigrants of which 70% would be in the age cohort of 18 years to 45 years. It further assumed that the workforce would increase annually by the addition of 150 returned migrants.

The AWG assumes a higher rate of migration in Malta over the period 2008 to 2060. This is shown in **Chart 02** below.

**Chart 02: Net Migration**

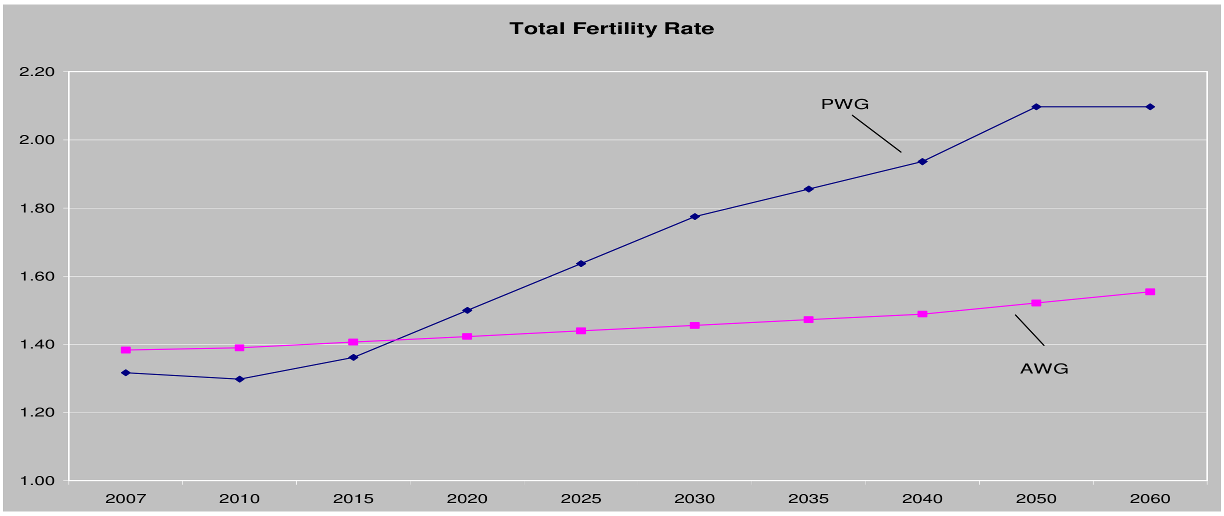


### 03.2.2 Total Fertility Rates

The PWG applied the total fertility rates as estimated in the demographic review by the NSO available at the time the data was inserted in the PROST model:  with the data having a 2002 base line. Calibrations were made to the data towards the latter part of the projected period to account for an increased fertility rate stemming from positive impacts of family friendly measures.

The AWG applied the EUROPOP 2008 fertility rates projection.  As can be seen from **Chart 03** below, the assumptions take by the PWG were more positive in that they project a reversal in the decline of the fertility rate from 2017 onwards.

**Chart 03:** **Total Fertility Rate**




### 03.2.3 Life Expectancy

The PWG applied the life expectancy projections as estimated in the demographic review by the NSO available at the time the data was inserted in the PROST model:  with the data having a 2002 base line.

The AWG based its assumptions on the EUROPOP 2008 life expectancy projections.  In essence these forecast an increase in life expectancy gains that is higher than the PWG base line.

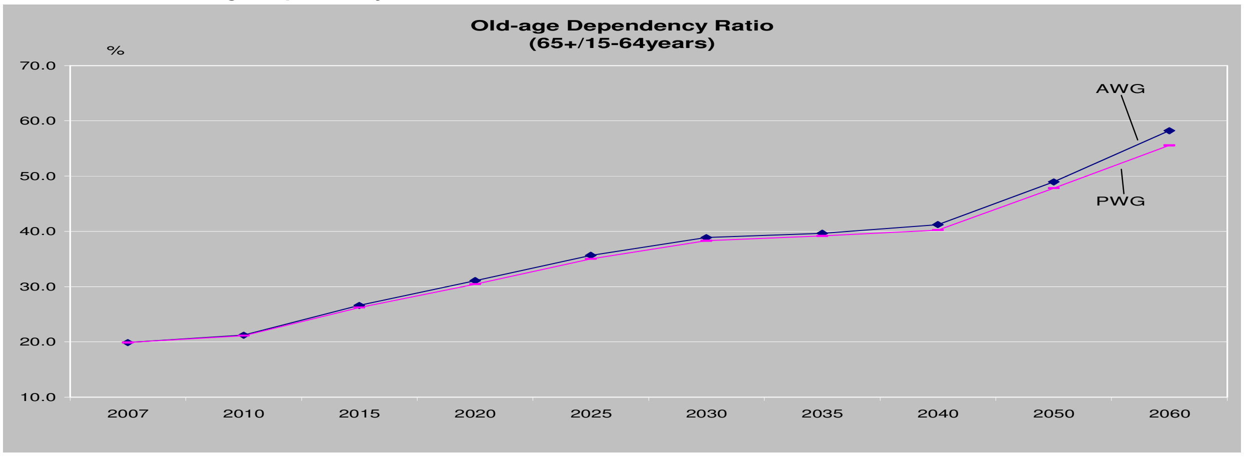
**Table 01:** **Gains in Life Expectancy**

| Gains in Life Expectancy:  Comparison of various projections (2008 – 2060) | | |
|---|---|---|
| | | |
| | Males | Females |
| | | |
| EUROPOP 2008 | 8.3 | 7.5 |
| | | |
| PWG Baseline | 5.1 | 4.2 |

### 03.2.4 Old Age Dependency Ratio

Although there are substantial differences between the demographic assumptions and data applied by the PWG and the AWG the old age dependency ratio – that is the number of persons working for every pensioner – is consistent. This is shown in **Chart 04** below.

**Chart 04: Old Age Dependency Ratio**

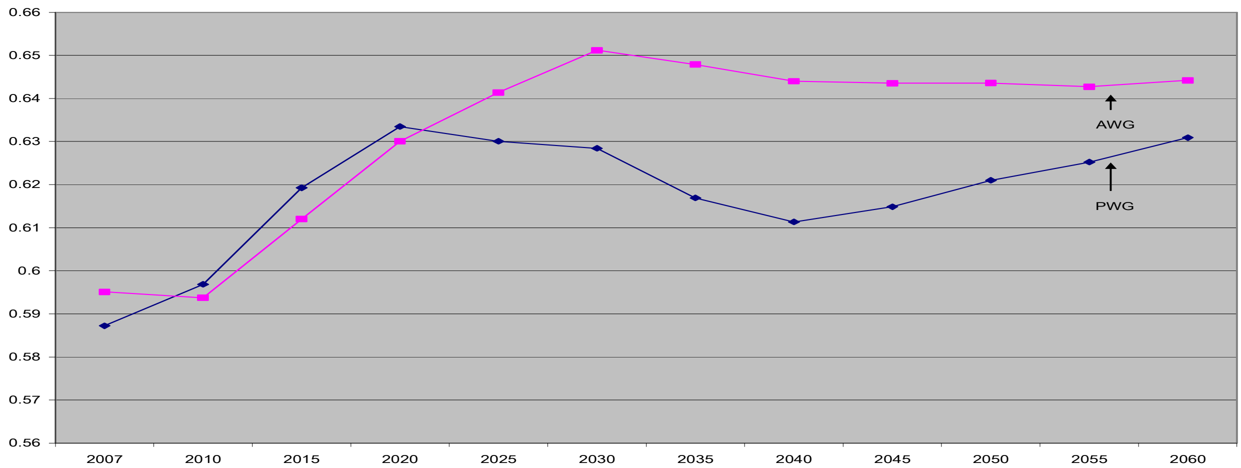



### 03.2.5 Participation Rates

In determining the participation rates, the PWG adopted the projected participation rates as applied by the WB in its modelling carried out between October 2003 and March 2004. The PWG amended this data in order to input the latest values as established by the Labour Force Participation Rate as provided by the then Labour Force Survey. The female labour participation rate was projected to increase to 52% by 2020 and 62% by 2050 on the basis that the younger and new generation of female entrants onto the market would have a higher incidence to work.

The AWG assumes that the participation rate for persons between the age of 15 years to 64 years will increase from 59.5% in 2007 to 64.4 in 2060 (64.4% also in 2040). As can be seen in **Chart 05** below, the participation rates applied by the PWG and the AWG behave differently.

**Chart 05: Participation Rates**

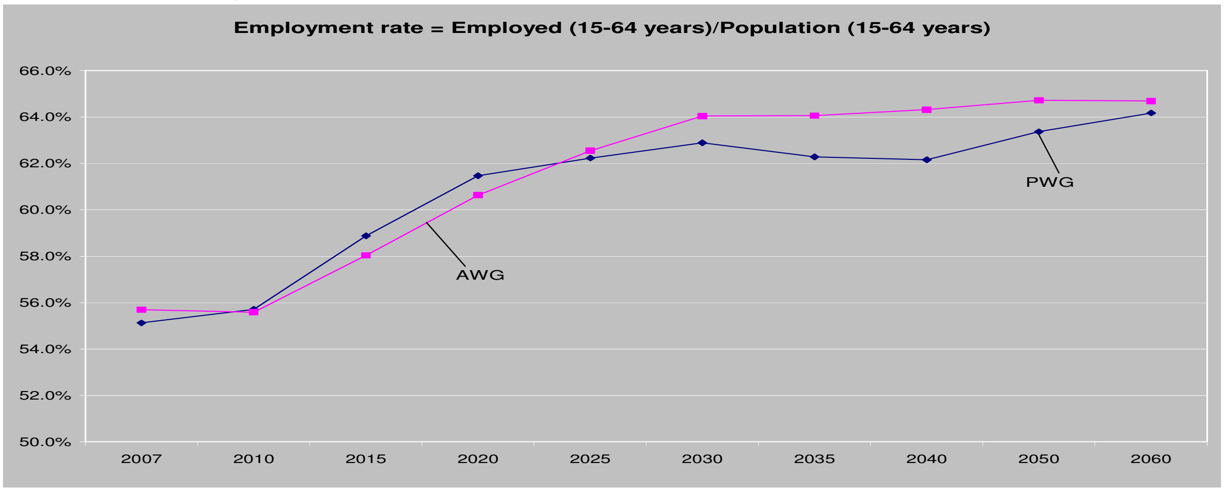


### 03.2.6 Employment Rates

In determining the employment rates, the PWG adopted the projected participation rates as applied by the WB in its modelling carried out between October 2003 and March 2004. The AWG assumes that the employment rate for persons between 15 years of age to 64 years of age will increase from 55.8% in 2007 to 64.4% in 2060.

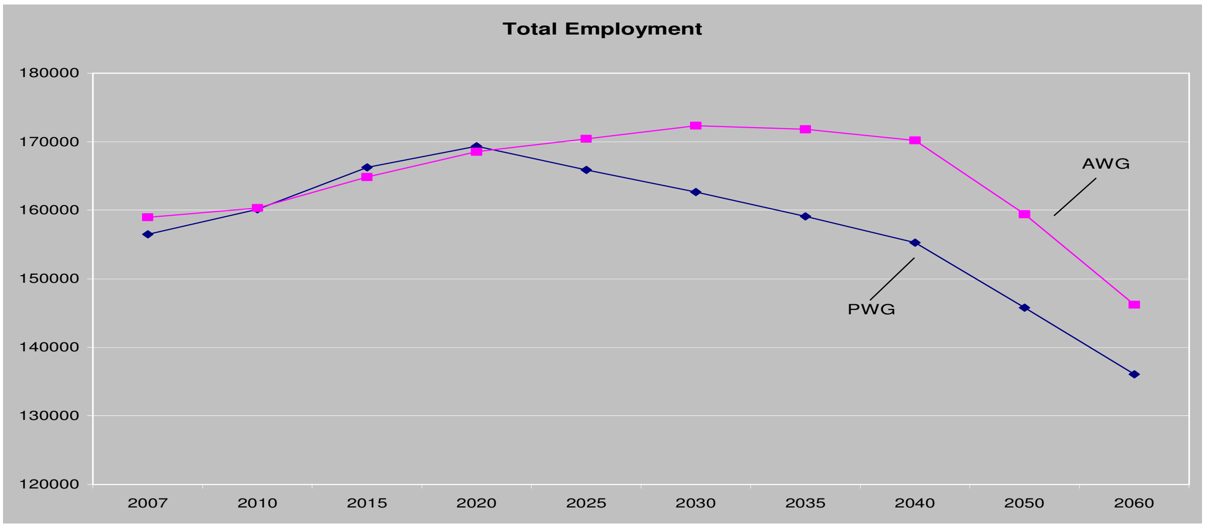
The performance of the assumptions by the two Groups is shown in **Chart 06** below.

**Chart 06: Employment Rates**




The projected employment base by the PWG and AWG respectively is shown in **Chart 07** below.

**Chart 07: Employment**




### 03.2.7 Inflation

The PWG adopted the NSO released inflation rate for the period 2002 to 2004 and the EPD inflation rate projections for the period 2005 to 2007. For the period 2008 to 2050 the PWG assumed an inflation rate of 2.2%.

The AWG assumes an inflation rate that would grow from 0.7% in 2007 to 2.0% in 2010 and remains constant thereafter.

### 03.2.8 Real Gross Domestic Product

The PWG assumed that GPD growth would reflect the following economic behaviour:

**Table 02: GDP Growth 2002 to 2050**[2]

| Year | Changes in GDP |
|---|---|
| 2005 | 1.7% (as at March 2005 EPD projections) |
| 2006 | 2.0% (as at March 2005 EPD projections) |
| 2007 - 2011 | 2.5% (as at March 2005 EPD projections) |
| 2012 | 3% |
| 2013 - 2015 | 3.5% |
| 2016 - 2025 | 4% |
| 2026 - 2050 | 2.5% |

The above assumptions took into account that Malta was restructuring its economy both in terms of closing down subsidised public entities, privatising and liberalising markets that were previously monopolistic, as well as moving out from low value manufacturing to high value added manufacturing and services. Furthermore, it took into account the aggressive introduction of Information, Communication and Technology (ICT) across both private and public entities which was seen to propel an increase in the Total Factor Productivity (TFP) due to inherent efficiencies that such ICT investment brings with it.

The effects arising from the above were seen5 between 2016 and 2025 and would subsequently level off at a 2.5% growth for the period to 2026 to 2050.

The AWG projected an averaged GDP growth rate of 1.75% over the period 2010 – 2050.[3]

### 03.2.9 Labour Productivity

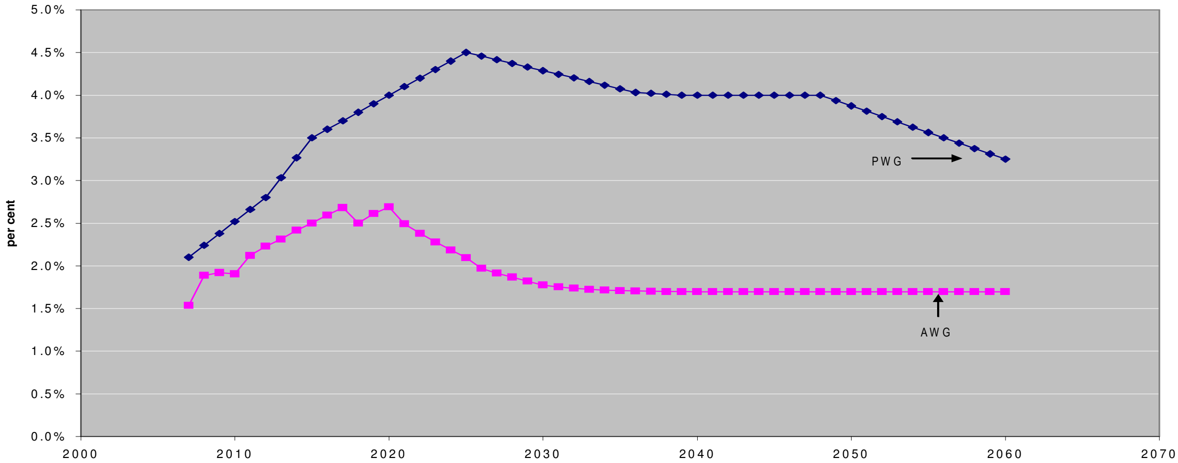
In determining the productivity rate the PWG applied the data used by the WB with the exception that with regards to the productivity growth of minimum wage workers the relevant input sheet within PROST was calibrated to approximate the wage bill to the nominal GDP ratio, in line with the latest published figures.

The AWG assumes a productivity rate that increases from 1.5% in 2007 to approximately 2.75% in 2020 before tailing off to 1.75% in 2030 and decreasing marginally thereafter. **Chart 08** below compares the labour productivity rates applied by the two Groups.

[2] Pg 65,

[3] The Methodology used by the Ageing Working Group is described in detail in the EC Publication "The 2009 Ageing Report: Underlying Assumptions and Projection Methodologies for the EU-27 Member States (2007-2060)" - http://ec.europa.eu/economy_finance/publications/publication13782_en.pdf

**Chart: 08 Labour Productivity Rate**




## 03.3 The Impact of the Macro-Economic and Demographic Assumptions of the Ageing Working Group vis-à-vis the Pensions Working Group

The modelling of the above macro-economic and demographic assumptions of the AWG on the reforms introduced by Government in 2007 show a significant departure with regards to the Average Pension Replacement Rate (APRR) and the pension deficit to GDP when compared to a similar simulation which is based on the PWG macro-economic assumptions. This is shown in **Table 03** below:

**Table 03: Outcomes of Impact of 2007 As a Consequence of Different Macro-Economic and Demographic Assumptions**

| | Pensions Working Group Assumptions | | Aging Working Group Assumptions | | Pensions Working Group Assumptions | Aging Working Group Assumptions |
|---|---|---|---|---|---|---|
| | Adequacy | | Adequacy | | Pensions Deficit to GDP | Pensions Deficit to GDP |
| | 2045 | 2050 | 2045 | 2050 | 2050 | 2050 |
| **First Pillar** | 33.3% | 29.4% | 42% | 42% | (2.6%) | (7.1%) |
| **Second Pillar** | 8.1% | 9.2% | Not Modelled | | None | |
| | **41.4** | **38.6** | **42** | **42** | | |

It is to be noted that the Second Pension framework is not modelled under the AWG assumptions. The PWG had proposed the introduction of initially, a mandatory, yet 'neutral' Second Pension between 2007 and 2011 by means of a 1% 'carve' out of the employer's and employee's National Insurance contribution respectively; to be followed by the introduction of a mandatory Second Pension that would see an increase to an additional 3% contribution by both employer and employee between 2011 and 2025.

The modelling carried out by the PWG in the final report has projected that a mandatory Second Pension would result in a replacement rate of 9.2% by 2050.

The different macro-economic assumptions show that under the AWG modelling a slightly higher APRR of 42% can be maintained by 2050 through the First Pension as against the 38.6% by 2050 under the PWG modelling that combines pensionable income from both a First Pension and a Mandatory Second Pension.

It follows, however, that the attainment of an APRR of 42% solely through a First Pension places greater pressure on the financial sustainability of the pension system. It is, therefore, not surprising that an APRR of 42% that is provided through the First Pension results in a Pensions Deficit to GDP of (7.1%) compared to the APRR of 29.4% provided through the First Pension with a Pensions Deficit to GDP of (2.6%).

The difference in the results between the PWG and AWG modelling stems primarily from the different GDP assumptions adopted in the two models. Analysis of the behaviour of the two models indicates that the main reason for the increase in the replacement rate of the First Pension and the pensions deficit in relation to GDP is the direct result of the parametric measure proposed by the PWG, and adopted by Government, that the Maximum Pensions Income Ceiling of the First Pension is to be automatically indexed to a mechanism that is constituted of 70% wages : 30% inflation.

It is pertinent to underline that the PWG had also proposed that this instrument would be subject to a 'Control Lever' that would be applied between one Five Year strategic review and the other; where-in the application of such an increase to the Maximum Pension Income Ceiling would be subject to the performance of the economy and public finances.

## 03.4 Determining the Macro-Economic and Demographic Assumptions Modeling

As shown in this Chapter, the PWG based its macro-economic and demographic assumptions on the data inputted in the PROST modelling carried out by the WB upon which its recommendations presented in the March 2004 report were based – with the exception of certain variables introduced by the PWG as described above.

As stated above the AWG modelling is based on a set of assumptions produced on the basis of a commonly-agreed methodology. This approach is based on what may be described as a convergence assumption in terms of demography, which is combined with a cohort method of projecting country specific participation rates used in turn to project the labour force. The labour force projection is combined with assumptions on structural unemployment and employment rates to generate estimates of total employees over the projection period. The projection of the number of employees is combined with assumptions on total factor productivity and capital deepening is used to produce GDP projections.

As shown in this Chapter the two sets of assumptions lead to considerably different sets of results. A question faced by the PWG2010 was whether (a) it should retain the previous PWG assumptions, (b) adopt 'Malta specific' economic and demographic assumptions that take into account the international and local economic and demographic forecasted behaviour; or (c) adopt the AWG assumptions.

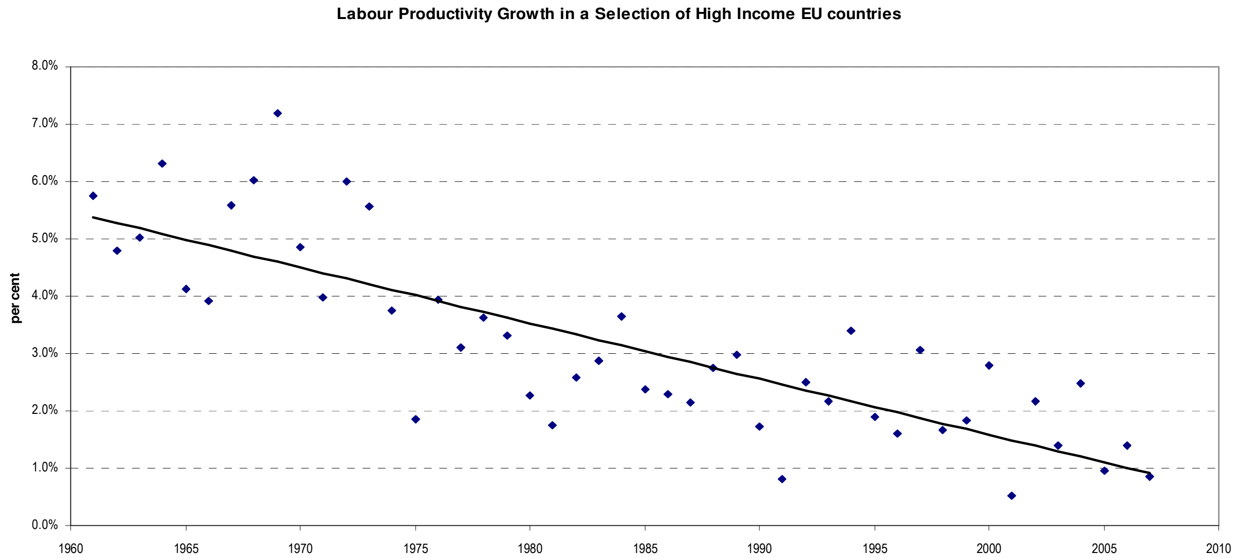
In contemplating Option B the PWG2010 assumed two scenarios – which are shown in **Table 04** hereunder:

**Table 04: Analysis of Malta Specific Labour Productivity Rate**

| Scenarios | Labour Productivity | Labour Utilisation | Demographic Factors | GDP |
|---|---|---|---|---|
| Trend Growth in Labour Productivity and Labour Utilisation | 2.0% | 0.4% | -0.5% | 1.9% |
| Labour Productivity Growing in Line with 'New Economy': Labour Utilisation Growing in Line with 1981-2007 trend growth | 2.3% | 0.4% | -0.5% | 2.3% |

As **Chart 09** below shows that productivity growth in today's high income countries has been on a declining trend over the past four decades.

**Chart 09: Labour Productivity Growth in a Selection of High Income EU Countries**




On the other hand, whilst trends for middle income countries are more unclear, the indications are that labour productivity growth may have reached a plateau.

**Chart 10: Labour Productivity Growth in Middle Income EU Countries**

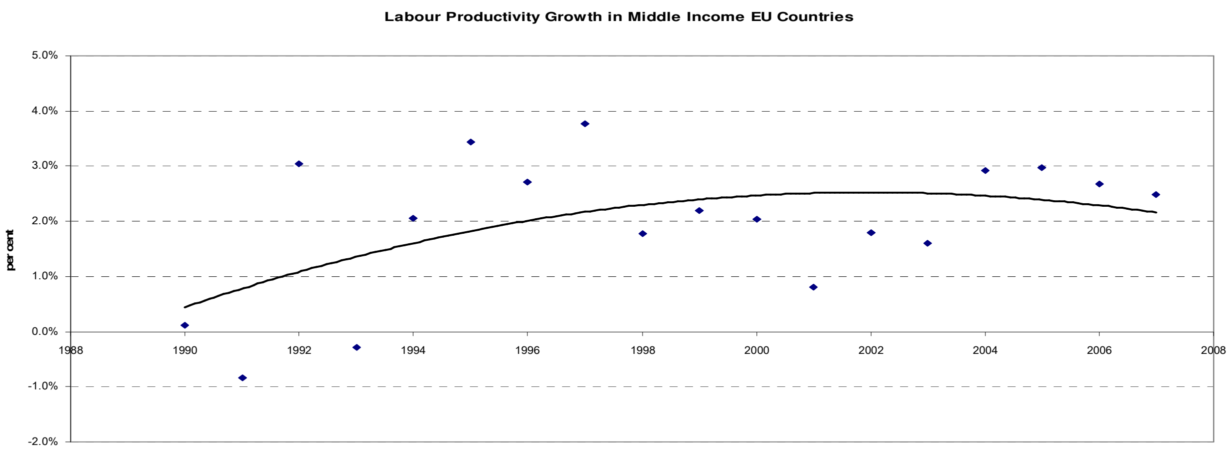


**Table 05** below shows the average labour productivity growth in EU middle income and low income Member States respectively between 1991 and 2007:

**Table 05: Average Productivity Growth in the EU: 1991 – 2007**

| Average Labour Productivity Growth in the EU: 1991-2007 (cont.) | | | |
|---|---|---|---|
| **Middle Income Countries** | | **Low Income Countries** | |
| Cyprus | 1.8% | Bulgaria | 1.5% |
| Malta | 1.7% | Estonia | 4.1% |
| Greece | 1.9% | Hungary | 2.4% |
| Portugal | 1.8% | Latvia | 3.5% |
| Czech Republic | 2.2% | Lithuania | 1.8% |
| Slovenia | 3.0% | Poland | 4.3% |
| | | Romania | 3.4% |
| | | Slovak Republic | 4.4% |
| Average: 1991-2007 | 2.1% | Average: 1991-2007 | 3.2% |
| Average: 2001-2007 | 2.2% | Average: 2001-2007 | 5.2% |

Note: High Income Countries are defined as countries exceeding 100% of GDP per capita in PPS for EU-27 in 2007

Medium Income Countries are defined as countries where per capita income exceeded 75% but was lower than 100% of GDP per capita in PPS for EU-27 in 2007

Low Income Countries are defined as countries where per capita income was lower than 75% of GDP per capita in PPS for EU-27 in 2007

The PWG2010 is recognisant of the fact that maintaining the macro-economic assumptions adopted by AWG with regards to Malta for the period 2010-2060 leads to results that are far more negative with regards to the sustainability of the First Pension that would otherwise be the case if a more positive macro-economic framework had to be applied – particularly with regards to the GDP assumption behaviour. This arises because in a PAYG First Pension the implicit rate of return is equal to the rate of growth of the GDP.

Indeed, the PWG2010 is of the considered opinion that the European Commission's (EC) concern on the long term sustainability of the pensions system in Malta is directly related to the results that stem from the AWG convergence model applied with regards to Malta.

Following long and careful consideration the PWG2010 concluded that the modelling it would carry out on its simulation of the behaviour of the pensions system would be based on the AWG macro-economic framework established for Malta even though the PWG2010 is of the considered opinion that the AWG macro-economic framework tends to bias towards a pessimistic scenario.

The PWG2010 reaches this conclusion for a number of important reasons. First, irrespective of the personal opinion of the members of the PWG2010 with regards to the AWG macro-economic framework, this framework is the formally approved benchmark established with regards to Malta for the simulation of economic and social behaviour with regards to pensions. Malta's measures, unless Malta re-opens the assumptions and methodology applied by the AWG, will be benchmarked by the EC and its institutions against this base-line.

Second, Malta does not have a sophisticated macro-economic modelling methodology and simulation framework that it could apply and which would justify the assumptions the PWG2010 would reach with results to the macro-economic framework. In essence, this means that any assumptions reached in this regard by the PWG2010 would be personal assumptions based on the PWG2010's collective understanding of how the economy would behave over a 50 year period.

Such assumptions will not be backed by a sound methodological framework. It is the PWG2010's position that such an approach would be highly dangerous given that assumptions taken by it without any methodological basis that portray a far more positive macro-economic framework than that presented by the AWG may give a false sense of security and mask the breadth and depth of the problems that need to be faced and addressed.

Additionally, and of considerable importance are the effects of the most severe financial and economic recession the world has seen in decades is leading respectable international economic institutions and economists to conclude that the crisis will leave a structural negative impact on the potential for economic growth in industrialised economies. Against this backdrop, a critical review of the economic growth assumptions underpinning the 2005 pensions review exercise is, therefore, in order. While no clear consensus has yet emerged on the magnitude of the negative dip in potential growth the current economic crisis is leaving and will leave on the industrialised world's ability to grow, it is deemed proper by the PWG2010 to adopt more conservative views on the growth possibilities for the Maltese economy for the projected period.

**Recommendation 01**

Whilst the 2010 Pensions Working Group is recognisant of the fact that maintaining the macro-economic assumptions adopted by Aging Working Group with regards to Malta for the period 2010-2060 leads to results that are far more negative than would otherwise be the case if a more positive macro-economic framework had to be applied given the fact that there is no local methodological basis upon which an alternative macro-economic framework can be designed the Group retains the Aging Working Group macro-economic framework for its modelling.

Be that as it may, the PWG2010 however, is also of the considered opinion that adopting a purist approach to rectify a negative potential state of play that will take place in 50 years on the basis of projections taken today is also a dangerous approach. Long term projections such as those taken with regards to pensions – which are necessary as they need to cover the life journey of an active labour participant – are intrinsically flawed.

50 years, half a century, is far too long a period of time to assume that projections made today will truly materialise as planned. It is pertinent to underline that only months after the Government launched the pension reforms in December 2007 on the basis of further modelling carried out by the PWG throughout that year, the world following the sub-prime crisis and the Lehman Brothers collapse suffered an economic and financial turmoil the effects of which are still very much with us today. Projected economic and GDP growth as forecasted by the PWG for the years 2008 – 2010 did not materialise as Malta's economy too felt the negative fallout of the crisis and subsequently dipped into recession.

Of truly worrying concern is that very few international economists expected a financial and economic crisis of this dimension in 2008 and the degree of rapidity with which it caught in its vortex the global economy and the financial markets.

It so follows that projections are just that: projections. They provide a basis to allow a policy maker to chart a way forward in a state of play where visibility even over a five year period is fraught with uncertainty and unknowns let alone a 50 year period where the degree of that uncertainty becomes tenuous at best.

The PWG2010, therefore, is strongly of the considered opinion that whilst Government should strive to strengthen the sustainability, adequacy and solidarity of the pensions system its goal should not be to rectify today the projection outcomes as they appear to be in 2060.

Rather, the PWG2010 proposes that the Government should continue to undertake calibrated reforms of the pensions system over a five year period as is now mandated by the SSA and in doing so adopting incremental measures that will have a long term impact towards the adequacy, sustainability and solidarity of the system.

| Recommendation 02 |
| --- |
| The 2010 Pensions Working Group recognises that assumptions over a 50 year period are tenuous at best thus recommends that the Government should not consider to rectify today the projection outcomes as they appear in 2060 but should continue to adopt a calibrated reform of the pensions system over a five year period as is now mandated by the Social Security Act and in doing so adopt incremental measures that will have a long term impact towards the adequacy, sustainability and solidarity of the pension system. |

An incremental approach, as proposed, will ensure that projections are calibrated on an on-going basis, measures introduced monitored and reviewed for their impact and behaviour, flexibility and rapidity in responding to changing circumstances as well as allowing for a smoothening of the impact of the measures that are introduced on society at large.

It is pertinent, however, to emphasise, that the incremental approach proposed by the PWG2010 should not be interpreted to mean that there is an abdication with regards to a number of challenging decisions that need to be taken by the polity at large. As will be shown in this Report there are key decisions that need to be considered and taken and timeframes set for a number of overarching reforms that go beyond the parametric changes to the First Pension introduced in 2007.

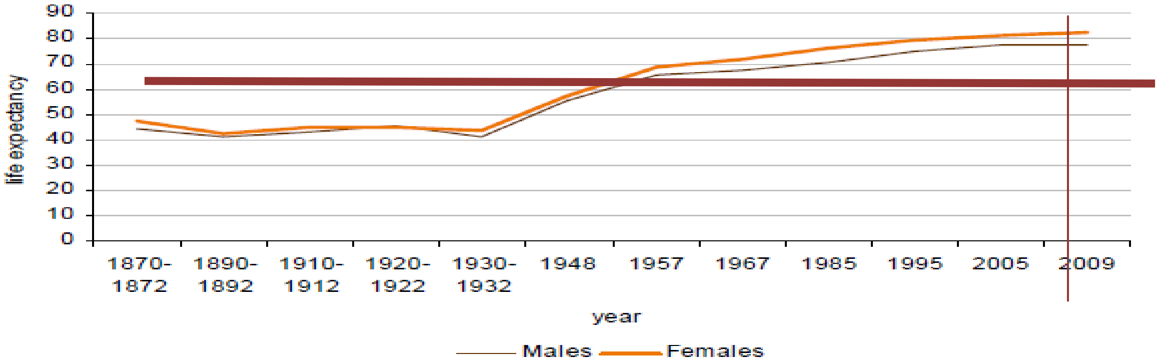
| Recommendation 03 |
| --- |
| The 2010 Pensions Working Group strongly emphasises that the proposed incremental approach to pension reform should not be interpreted to mean that no reform is required or that there is no urgency in the need for continued reform: key decisions need to be considered and taken and timeframes set for a number of overarching reforms that go beyond the parametric changes to the First Pension introduced in 2007. |

## 04.1 Changes to the Demographic Profile

The PAYG pension system which is the system, upon which the First Pension in Malta is based, is intrinsically tied to demographics. The PAYG pension system can be crudely defined to mean that a person in active employment today is paying for the pension of a pensioner today; and the pension of the person in active employment today is to be paid by a person who is yet to enter the labour market.

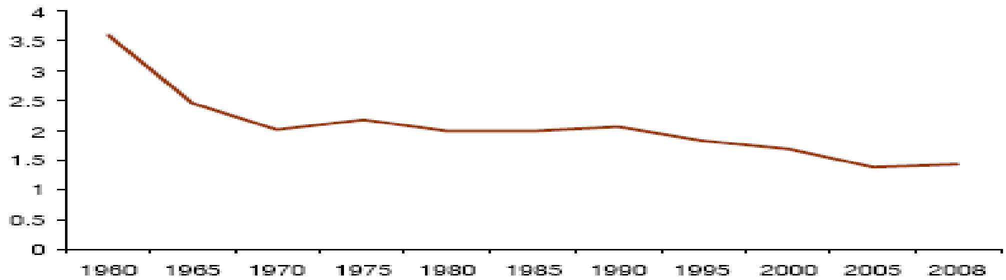
A PAYG pension system will remain sustainable if the ratio between a pensioner : a labour participant : a person who is yet to enter the labour market remains constant. This, however, is not the case. The break-through in medical technologies and the increase in quality of life have resulted in a longer longevity for both males and females. This means that people are living longer, with a higher quality of health. It also means that the longevity period over which a pension is paid out once a person retires from active participation is getting longer.

**Chart 11: Expectation of Life: 1870/72 - 2009[4]**




Conversely the total number of live births in Malta continues to fall. In 1944, life births per 1,000 population stood at 39.3. By 1995 this fell down to 12.44 per 1,000 population. In 2009, the total fertility rates remained unchanged at 1.4.

**Chart 12: Expectation of Life: Total Fertility Rates: 1960 - 2008[5]**




According to population projections produced by NSO with the 2009 population as base, the total population is expected to decrease to 380,242 in 2050. Projections also reveal a continuously ageing population, with the share of elderly persons increasing in comparison with their younger counterparts.

[4] Pg x, Demographic Review, 2009, National Statistics Officer, September, 2010
[5] Pg vii, Demographic Review, 2008, National Statistics Officer, September, 2009

In fact, in 2050 the percentage of persons aged less than 20 is expected to decrease from 22%, as recorded in 2009, to 17%. On the other hand, the share of individuals aged 65 and over is expected to increase significantly in the coming forty years to 24% from the 15% recorded for the year under review.

**Chart 13: Population Pyramid 2009**[6]

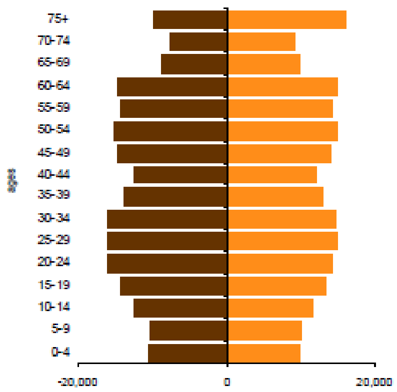



**Chart 14: Population Pyramid 2015**[7]

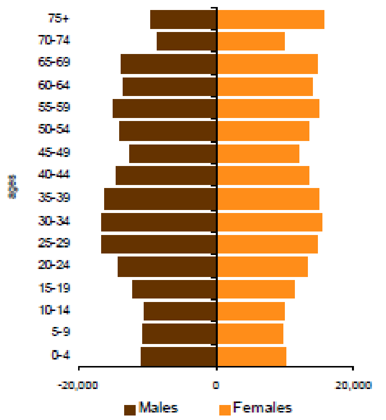
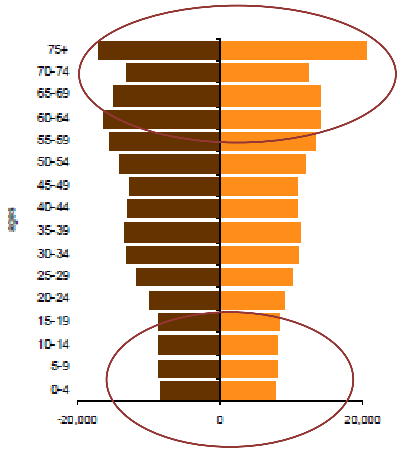


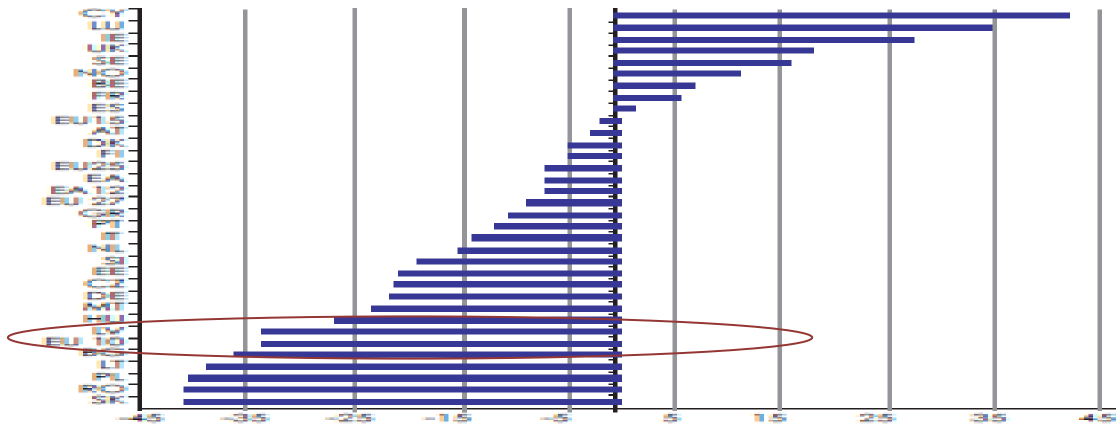

**Chart 15: Population Pyramid 2050**[8]




The above projections demonstrate that Malta's population is not only aging, but, unless fundamental conditions change, it is also decreasing. In terms of the demographics pensions replacement ratio this means that whilst in 2009 that were 4 persons in employment for every person in retirement, in 2060 this will fall to 1.5 persons in employment for every person in retirement.

Demographics projections, such as macro-economic projections, are based on assumptions which may be subject to change over a long term period such as the one under review. The trend in the fertility rate – which in Malta's case has been decreasing – and in the longevity index – which has been increasing – are well established. Under current demographic projections, as is shown in the Figure below, Malta will have a child deficit compared to the 2008 demographic base line of nearly 25%.

**Chart 16: Projection of Children below 15 Years by 2060**



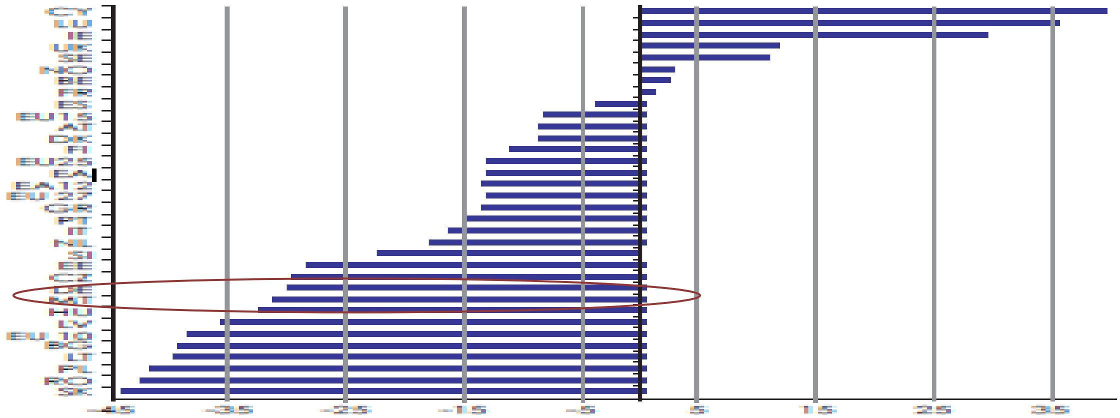
Source: Europop 2008

[6] Pg VII, Demographic Review, 2009, National Statistics Officer, September, 2010
[7] Ibid
[8] Ibid

The uncertainty with regards demographic changes lies in the extent that the fertility decrease can be turned around and to what extent this can be increased, the extent that the Maltese population will embrace immigration and residency with particular regards towards addressing gaps in skills deficits and the extent that technological innovation will continue to extend longevity and the quality of life in aging.

These are the fundamental conditions that constitute the basis of demographic projections: which in turn form the foundation basis of the PAYG pensions system. As can be seen from the Figure below Malta by 2060 will have a working population deficit for persons aged 15 to 65 years of age of slightly over 30% compared to the 2008 demographic baseline.

**Chart 17: Projection of Working Age Workforce (15 to 65 Years of Age) by 2060**




Source: Europop 2008

Unlike other industrialised societies Malta has a particular state of play that should allow it, at least in the short and medium term, to compensate for negative changes in the demographic profile of Malta. The fact that Malta has a low active participation rate in the labour market provides Malta, therefore, with elbow room to cushion the impact of the decrease in the population on the continued ability for the PAYG First Pension to meet society's needs in so far that Malta's active participation rate is brought up to EU levels.

Be that as it may, unless these fundamental conditions of the demographic profile of Malta are somehow managed the PAYG pension system will in the long term be neither adequate nor sustainable – even though the demographic deficit may in the short and medium term be, in part, masked by an increased activity rate.

### 04.1.1 Increasing the Fertility Rate

The decrease in the fertility rate should be a matter of national concern. There is no doubt that the Government has particularly over the past decade sought to introduce pro-natal measures to revert the trend in the fertility rate. As shown earlier in Chart 12 the decreasing trend in the fertility rate seems to have been stemmed – but this has not, at least as yet, been followed by a reversion of the trend.

Research shows that Government policies can have an impact on fertility. Yet, research further shows that no single policy intervention by itself will reverse low fertility in all cases. In recent decades France has had success by focusing on the birth of the third or subsequent child. The literature, however, tends to suggest that this is less attributable to a single policy mechanism than to its ability to create an environment, that encourages child bearing. This environment is created by a combination of policies that jointly serve this aim.[9]

[9] Page XVI, Grant, J., Hoorens, S., van het Loo, M., DaVanzo, J., Gibson, S., and Butz, W., Low Fertility and Population Aging: Causes, Consequences, and Policy Options, RAND Europe prepared for the EU Commission, 2004

Sweden has been successful in reversing fertility declines through a different set of policies. Its policy of parental leave during the 1980s allowed many women to raise children and remain in the workforce. In Sweden, neither high-quality childcare nor extensive parental leave on reasonable economic terms appears to be individually responsible for the relatively high fertility rates in the late 1980s. It appears that the *combination* of policies targeted at equal responsibilities for men and women as wage earner and care provider, and at the welfare of children, was essential for supporting family formation and the quality of family life.[10]

What works in one country may not work in another. The literature shows that a correlation between the magnitude of social transfers to the family and fertility levels exists in several countries while this correlation is absent in others, although it should be stressed that this in itself does not imply causality.

With regards to Malta, statistics seem to show that there is a strong correlation between child bearing and the active participation of females in the labour force. Table 06 below shows that that whilst the participation of females without children in the Age Group 25 – 49 is high – at 65.6% - this falls significantly within the same age group for females with children: 31.4%.

This seems to show that policy measures directed on the one hand to increase active participation of females in the labour market and on the other hand to increase child birth work at different poles. A female that will have a child is less likely to enter or re-enter the labour market force.

**Table 06: Employment Rates of Individuals with and without Children (under 15), 2006: Age Group: 25-49**[11]

| | Without children | | With children | | Difference | |
|---|---|---|---|---|---|---|
| | Women | Men | Women | Men | Women | Men |
| EU-27 | 78.3 | 82.4 | 67.0 | 90.0 | -11.3 | 7.7 |
| EA-15 | 77.3 | 82.8 | 66.3 | 91.6 | -10.9 | 8.8 |
| BE | 75.8 | 81.4 | 72.4 | 91.4 | -3.5 | 10.0 |
| BG | 77.3 | 77.1 | 71.4 | 81.2 | -5.9 | 4.1 |
| CZ | 84.8 | 87.8 | 68.3 | 93.7 | -16.5 | 5.9 |
| DE | 82.3 | 81.6 | 68.5 | 90.6 | -13.8 | 8.9 |
| EE | 85.6 | 83.5 | 78.7 | 93.2 | -7.0 | 9.7 |
| EL | 67.3 | 86.2 | 59.4 | 95.1 | -7.9 | 8.9 |
| ES | 75.0 | 84.1 | 60.6 | 91.3 | -14.4 | 7.2 |
| FR | 79.9 | 81.1 | 72.0 | 91.3 | -7.9 | 10.3 |
| IT | 68.2 | 82.6 | 55.8 | 91.7 | -12.4 | 9.1 |
| CY | 82.3 | 87.2 | 73.2 | 95.2 | -9.1 | 8.0 |
| LV | 81.8 | 78.9 | 77.4 | 87.4 | -4.5 | 8.5 |
| LT | 83.0 | 78.0 | 80.1 | 88.1 | -2.9 | 10.0 |
| LU | 82.8 | 90.1 | 65.4 | 94.8 | -17.4 | 4.7 |
| HU | 79.2 | 80.5 | 62.2 | 85.4 | -17.1 | 4.9 |
| MT | 65.6 | 87.6 | 31.4 | 93.2 | -34.2 | 5.6 |
| NL | 85.1 | 87.7 | 73.8 | 94.2 | -11.3 | 6.5 |
| AT | 83.6 | 88.5 | 73.9 | 93.1 | -9.7 | 4.5 |
| PL | 74.1 | 72.6 | 66.2 | 84.6 | -7.8 | 12.1 |
| PT | 76.2 | 82.5 | 76.9 | 91.9 | 0.7 | 9.4 |
| RO | 73.6 | 78.7 | 69.6 | 83.5 | -4.0 | 4.8 |
| SI | 79.0 | 83.1 | 85.6 | 93.2 | 6.6 | 10.1 |
| SK | 79.3 | 79.0 | 66.7 | 88.6 | -12.5 | 9.6 |
| FI | 81.8 | 80.4 | 76.8 | 92.5 | -5.0 | 12.1 |
| UK | 85.6 | 85.5 | 68.4 | 90.9 | -17.1 | 5.4 |

Moreover, as is shown in **Table 07** below, the larger the family, the less likely it is that the female will take an active part in the labour market whilst also assuming family rearing responsibilities.

[10] Ibid
[11] Pg 32, Reconciliation Between Work, Private and Family Life in the European Union, Eurostat Statistical Books, 2009 Edition

**Table 07:Employment Rates by Number of Children 2006 (%): Age Group: 25-49[12]**

| | Men | | | Women | | |
|---|---|---|---|---|---|---|
| | Number of children | | | Number of children | | |
| | 1 | 2 | 3+ | 1 | 2 | 3+ |
| EU-27 | 89.4 | 91.8 | 86.7 | 71.2 | 67.3 | 53.0 |
| EA-15 | 90.8 | 93.2 | 89.6 | 70.3 | 65.9 | 53.9 |
| BE | 91.2 | 93.7 | 87.1 | 75.9 | 76.3 | 58.0 |
| BG | 83.1 | 81.8 | 58.5 | 75.2 | 70.8 | 36.6 |
| CZ | 92.9 | 95.6 | 88.4 | 69.4 | 70.9 | 51.3 |
| DE | 90.2 | 92.4 | 85.9 | 73.9 | 67.7 | 49.6 |
| EE | 93.1 | 94.3 | 90.4 | 83.4 | 76.2 | 64.0 |
| EL | 93.2 | 96.7 | 94.9 | 61.4 | 59.2 | 52.9 |
| ES | 90.2 | 92.6 | 90.9 | 64.7 | 58.1 | 50.3 |
| FR | 90.5 | 92.5 | 90.2 | 77.5 | 73.9 | 56.7 |
| IT | 90.5 | 93.2 | 90.9 | 60.1 | 53.5 | 41.8 |
| CY | 92.9 | 96.0 | 96.9 | 76.6 | 76.2 | 63.3 |
| LV | 87.3 | 89.4 | 82.6 | 80.3 | 77.2 | 65.1 |
| LT | 85.7 | 90.3 | 88.0 | 81.5 | 81.6 | 72.0 |
| LU | 93.2 | 95.7 | 95.7 | 74.0 | 65.2 | 51.1 |
| HU | 85.7 | 88.9 | 75.9 | 66.5 | 66.4 | 39.1 |
| MT | 93.6 | 94.7 | 89.8 | 39.1 | 27.8 | 21.7 |
| NL | 93.7 | 95.5 | 92.1 | 75.3 | 76.5 | 65.1 |
| AT | 93.4 | 94.0 | 89.3 | 80.1 | 72.3 | 57.9 |
| PL | 83.3 | 86.6 | 83.3 | 69.6 | 66.9 | 57.0 |
| PT | 91.5 | 93.6 | 86.8 | 78.0 | 77.5 | 65.8 |
| RO | 84.4 | 84.9 | 75.3 | 73.9 | 69.1 | 53.4 |
| SI | 91.2 | 94.9 | 94.1 | 84.3 | 87.2 | 84.7 |
| SK | 89.6 | 91.7 | 79.0 | 70.1 | 69.6 | 52.2 |
| FI | 92.0 | 93.1 | 92.2 | 78.7 | 80.9 | 66.5 |
| UK | 91.5 | 92.7 | 85.4 | 75.5 | 71.0 | 47.9 |

The number of females with one child in the labour market stands at 39.1%. This falls significantly once a second child is born – 27.8% - and further still with the addition of a third child: 21.7%.

Whilst the above statistics do not show the quantum of females who return into the labour force following the birth of a first, second and third child, the fact that the labour participation rate of females who joined the labour market between 2000 and 2008 increased only from 33.1% to 37.4% seems to show that the number of re-entrants seem to be on the low side once the decision to raise a family is taken.

Moreover, as is shown in **Table 08** below, whilst the number of legitimate child births for females under 20 has increased by 61.7% (107 births), the number of legitimate children born by females who are 20 to 24 has fallen considerably; from 1,530 in 1980 to 600 in 2009: a decrease of 930 child births between the two periods. This has been, however, partially compensated by an increase of 329 annual births born to single parents between the two periods.

**Table 08: Life Births by Age of Mother: 1980 - 2009[13]**

| Live Births by Age of Mother | 1980 | | 1985 | | 1990 | | 1995 | | 2000 | | 2005 | | 2009 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Maltese & other births | Illegitimate Births | Maltese & other births | Illegitimate Births | Maltese & other births | Illegitimate Births | Maltese & other births | Illegitimate Births | Maltese & other births | Illegitimate Births | Maltese & other births | Illegitimate Births | Maltese & other births | Illegitimate Births |
| Under 20 | 174 | 59 | 195 | 21 | 164 | 24 | 201 | 59 | 249 | 143 | 230 | 210 | 281 | 260 |
| 20 - 24 | 1,530 | 14 | 1,170 | 17 | 2,007 | 28 | 986 | 67 | 900 | 155 | 661 | 248 | 600 | 343 |
| 25 - 29 | 2,018 | 19 | 2,067 | 14 | 2,157 | 19 | 1,730 | 35 | 1,590 | 87 | 1,438 | 160 | 1,389 | 265 |
| 30 - 34 | 1,470 | 15 | 1,342 | 11 | 1,456 | 13 | 1,371 | 31 | 1,086 | 41 | 1,111 | 111 | 1,316 | 163 |
| 35 - 39 | 503 | 7 | 678 | 3 | 580 | 10 | 590 | 17 | 444 | 29 | 327 | 34 | 472 | 87 |
| 40 - 44 | 117 | 3 | 128 | | 195 | 1 | 120 | 3 | 113 | 8 | 83 | 16 | 73 | 15 |
| 45 - 49 | 4 | 1 | 3 | | 9 | | 5 | 1 | 4 | 1 | 5 | | 3 | 1 |
| 50 - 54 | | | | | | | | | | | 3 | | | |
| 55 - 59 | | | | | | | | | | | | | | |
| 60 - 64 | | | | | | | | | | | | | | |
| 65+ | | | | | | | | | | | | | | |
| | 5816 | 118 | 5583 | 66 | 6568 | 95 | 5003 | 213 | 4386 | 464 | 3858 | 779 | 4134 | 1134 |
| | 5934 | | 5649 | | 6663 | | 5216 | | 4850 | | 4637 | | 5268 | |

[12] Pg 33, Ibid
[13] Ad hoc Statistical Report created by the National Statistics Office, Malta on behalf of the New Pensions Working Group

The above seems to show that whilst live births have gone down by 21.8% between 1980 and 2005 – with a resurgence occurring in 2009 where-in the decrease against the 1980 baseline is only 11.22%, there has also been a shift which indicates that more families made a decision to have no children during the age when the mother is 20 to 24 years of age.

This shift to have less children during this cohort age is not compensated by an increase in the rate of birth of children when the mother is 25 to 29 years of age as in this case, too, the live births experience a consistent decreasing trend.

The pattern is also repeated between 1980 and 2000 for women who are of 30 to 34 years of age although a reversal of this trend has occurred since 2005. In fact in 2005 the live births of this cohort increased marginally over 2000 and increased in 2009 over 2005 by 18.45%. It is of particular note that there was also a corresponding increase of children with unknown father for the same cohort over the past ten years.

Although it is early to say, it seems that over the past 10 years a conscious decision is being taken by families to have a first or second child at a later age – with a compensating shift for the decrease in child bearing within the 20 to 24 years cohort starting to occur, as well as the potential phenomena that an increasing number of females are deciding to raise a single parent family or non legally married families deciding to raise a new family.

Finally, whilst child bearing in married families has been falling consistently, single parent child bearing has, on the other hand, increased significantly. In 2009, 1 out of every 4.6 children was born to a single parent.

It is pertinent to underline that the 2007 Pensions Reform sought to use the pension system as one of the policy investments directed to support pro-natal growth at the one hand and to seek to attract the member of the family who exited to take up child rearing responsibilities to re-enter into the labour market on the other. Although the policy measure is gender neutral, given the cultural context of Malta there is no doubt that this measure was primarily directed to attract females to re-enter the labour force following a period of child rearing and family up-bringing.

There is, also, no doubt that the Child Rearing Credit measure, discussed in Chapter 02, was a positive pro-natal policy measure. Nevertheless, with the benefit of hindsight, the PWG2010 is of the considered opinion that the positive effects sought by the introduction of this measure were neutralised, vis-a-vis females, when the accumulation period for a full pension entitlement was increased to 40 years – given that the accumulation period to attain a full pension now increased further and rendered it more difficult for females to attain as too often, due to child rearing and parental responsibilities, they have an interrupted career history.

The PWG2010, whilst believing that the pensions system should support pro-natal policies, is of the considered opinion that calibration is required to the said Child Rearing Credit measure in order to compensate for the neutralisation effect arising from the increased contribution period.

The PWG2010 further believes that calibration in this regard should be pro-natal biased. Thus, it recommends that the Child Rearing Credit measure should be re-calibrated in a manner that biases towards a family which has more than one child by providing them with more favourable credits for a second and a third child.

The PWG2010 therefore, recommends that the Child Rearing Credit measure is amended as follows – with changes to be affected to the law retro-actively to 1st January 2011 with regards to parents born on or after 31st December 1961:

- A first child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of two (2) years or six (6) years as the case may be subject to the condition that the beneficiary returns to employment for a period of two (2) years.

- A second child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of three (3) years or eight (8) years as the case may be subject to the condition that the beneficiary returns to employment for a period of three (3) years.

- A third or further child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of five (5) years or ten (10) years as the case may be subject to the condition that the beneficiary returns to employment for a period of five (5) years.

**Recommendation 04**

Whilst the introduction of the Child Rearing Credit measure was a positive pro-natal policy design measure within the First Pension system, its desired effect with regards to women who have to interrupt their career due to child rearing was neutralised by the increase in the contributory period which rendered it even harder for a female to achieve the full contribution period. To compensate for this neutralising effect the 2010 Pensions Working Group proposes that the Government should consider amending the Child Rearing Credit and calibrating it on the basis of a pro-natal bias with the said amendment to take effect retro-actively as at 1st January 2011:

- A first child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of two (2) years or six (6) years as the case may be subject to the condition that the beneficiary returns to employment for a period of two (2) years.

- A second child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of three (3) years or eight (8) years as the case may be subject to the condition that the beneficiary returns to employment for a period of three (3) years.

- A third or further child under six (6) years of age or ten (10) years if the child suffers from a serious disability a credit of five (5) years or ten (10) years as the case may be subject to the condition that the beneficiary returns to employment for a period of five (5) years.

Furthermore, the PWG2010, with the benefit of hindsight, is also recognisant of the fact that the Child Rearing Credit as introduced in the 2007 reform negatively affected parents classified within the transitional cohort – that is persons who were 46 to 54 years of age as at 1st January 2007. Thus, the PWG2010 recommends that parents within this age cohort as at 1st January 2007 are provided with:

- a one (1) year pension credit for each child born under six years of age; or

- A two (2) year pension credit for each child born suffering from a serious disability under the age of ten

subject to the condition that the parent will return to work for an equivalent time period.

**Recommendation 05**

The 2010 Pensions Working Group, with the benefit of hindsight, is also recognisant that the Child Rearing Credit as introduced in the 2007 reform negatively affected parents classified within the transitional cohort and therefore recommends that parents within this age cohort are provided backdated to 1st January 2007 with:

- a one (1) year pension credit for each child born under six years of age; or

- A two (2) year pension credit for each child born suffering from a serious disability under the age of ten

subject to the condition that the parent will return to work for an equivalent time period.

As discussed earlier the mere transposition of pro-natal policies that have worked successfully in other jurisdictions may not necessarily work within the context of Malta's cultural, economic and social milieu. Nevertheless, as discussed above recent data seems to show that the decline of the fertility rate has plateau – although the dynamics of when child births occur and the legal status of how they occur have shifted. A levelling of the decline of the birth rate, whilst a positive development, does not provide for the demographic revitalisation required to counter Malta's aging and shrinking population – and in doing so minimising the demographic risks to the PAYG First Pension.

Thus, the further alignment of the pensions system to support pro-natal policies should, however, be complemented by a holistic review that should undertake a thorough and in-depth study of the measures that Malta should embrace to bridge what currently constitute opposing poles: the responsibility of a raising a family with the aspiration to remain an active participant in the labour market.

**Recommendation 06**

Whilst recent data seems to show that the decline of the fertility rate has plateaued this does not provide for the demographic revitalisation required to counter Malta's aging and shrinking population – and in doing so minimising the demographic risks to the PAYG First Pension – and the Government should consider appointing a Task Force to present to it at the earliest possible recommendations on a holistic pro-natal policy framework that balances the responsibility of a raising a family with the aspiration to remain an active participant in the labour market.

### 04.1.2 Increasing Active Participation in the Labour Market

The active labour participation rate in 2009 stood at 59.4%, of whom 54.9% are in employment. Thus, if one had to remove those persons who are unemployed, invalid, and are aged 70+ and over, it is immediately evident that the two cohorts of the Maltese population who are least active in the labour market are females and retired persons between 62 and 69 years of age.

**Table 09: Labour Force Survey Indicators**[14]

| | 2008 | 2009 |
|---|---|---|
| | Oct-Dec | Oct-Dec |
| Labour Supply | 171,498 | 175,940 |
| Employment | 160,673 | 162,918 |
| Unemployment | 10,825 | 13,022 |
| Inactive | 175,379 | 175,007 |
| Activity rate (%) | 58.7 | 59.4 |
| Employment rate (%) | 55.0 | 54.9 |
| Unemployment rate (%) | 6.3 | 7.4 |

*Source: National Statistics Office*

In a state of play where Malta's demographic population is aging and decreasing, the need to secure a higher level of active participation by those cohorts of the Maltese population who can play a role in the labour market assumes far more significant importance both for promoting economic growth, as well as to secure the sustainability of the pension system by means of increasing the contributory base of the First Pension.

It is pertinent to underline that the Government has, over the past years, adopted a series of policy measures to secure a higher degree of labour participation.

[14] Pg 32, Pre Budget 2011: Ideas, Vision, Discussion, Ministry of Finance, the Economy and Investment, July2010

#### 4.1.2.1 Labour Participation of Invalid and the Disabled Persons

In 2006, the Ministry for the Family and Social Solidarity introduced a reform of the medical assessment process for social benefits – including entitlement to the Contributory Invalidity Pension. The reform, which included measures that range from requesting more medical data and placing part of the responsibility on the claimant to the introduction of an independent systems audit, has been successful.

**Table 10: New Awards of Invalidity Pensions**[15]

| INVALIDITY PENSIONS | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|---|---|---|---|
| DNIP DECREASED NATIONAL INVALIDITY | 1 | 2 | None | None | None | 2 | 1 | None | None | None |
| IIP INCREASED INVALIDITY PENSION | 33 | 25 | 39 | 27 | 9 | 12 | 5 | 19 | 17 | 3 |
| IP INVALIDITY PENSION | 74 | 242 | 405 | 328 | 285 | 279 | 146 | 94 | 59 | 72 |
| NMIP NATIONAL MINIMUM INVALIDITY | 722 | 563 | 1019 | 1121 | 909 | 888 | 524 | 555 | 431 | 400 |

As can be seen from the above Table, the number of new pension awards following the introduction of the invalidity reform fell dramatically. The PWG2010 is of the considered opinion that the new medical assessment process for social benefits has had a positive impact and future measures should be directed to strengthen it.

**Recommendation 07**

The 2010 Pensions Working Group is of the considered opinion that the new medical assessment process for social benefits has had a positive impact and future measures should be directed to strengthen it.

One way of how the invalidity framework can be further improved in order to retain people who suffer a disability in the labour market is to reform the invalidity framework from one that targets the condition of the disability to one that targets the degree of dysfunction arising from the said condition. As can be seen from the Table below, nearly one third of disabilities occur when a person is an active participant in the labour market.

**Table 11: Onset of Disability**

| | |
|---|---|
| From birth | 25.4 |
| 0 – 19 years | 19.1 |
| 20 – 59 years | 32.5 |
| 60+ years | 22.5 |
| No answer | 0.5 |
| **Total** | **100.0** |

Source: National Council for Persons with Disability

Thus, for example, a person who suffers a leg disability may no longer be in a position to continue in his or her current job particularly if that job requires a high degree of mobility. Nevertheless, the said person can, and should be retrained, to take on a new job which requires little, if any, mobility.

[15] Ad Hoc Report by the National Statistics Office carried out on behalf of the New Pensions Working Group

A disability, therefore, is not necessarily an impediment to active participation in the labour market if the appropriate support structures that provide therapy, re-skilling, psychological support, et al are holistically in place.

The PWG2010 is aware that an inter-government committee is set up to study the introduction of such a reform and encourages this committee in its work as such a reform would transform the paradigm from one that basis invalidity on a person's condition to one that determines the degree of the invalidity to the person's ability to function.

| **Recommendation 08** |
|---|
| The 2010 Pensions Working Group recommends that the Government should, as a further phase of the reform of the invalidity and disability pension system, give serious consideration to transform the paradigm from one that bases invalidity as a result of a condition of the said disability to one that determines the degree of the invalidity to the person's ability to function; together with the holistic underlying support (re-skilling, psychological support, etc) required to achieve such a paradigm shift. |

Should Government consider such a reform, the nature of both the Invalidity and Non-Contributory disability pension should change. The current provision of a full pension subject to the condition that with regards to a person who is classified as:

(a) invalid he or she opts out of the labour market; and

(b) disabled person participates in the labour market but has his or her disability pension capped against income earned;

should be changed to a system where the pension provided to the individual reflects the degree of the incapacity whilst allowing the said person to continue to participate in the labour market where income would no longer be capped to against income earned.

A reform of the invalidity process, on the principles discussed above, would, therefore, incentivise persons who qualify for a functional based disability pension to continue to remain active in the labour market whilst receiving a pension that represents the degree of functionality lost.

| **Recommendation 09** |
|---|
| The 2010 Pensions Working Group recommends that, should the Government consider a reform as proposed in **Recommendation 08**, the pension awarded should change to one which reflects the degree of the functional incapacity whilst allowing a person to continue to participate in the labour market to earn income as appropriate. |

#### 4.1.2.2 Labour Participation of Females

Over the past decade, the Government introduced a number of family friendly measures directed to ensure that parents, particularly women, are in a better position to balance their family responsibilities whilst at the same time remain in employment. Technology too has been applied to allow parents to be able to better share family responsibilities and tele-working as a new form of job design has taken root in Malta. State child care facilities have also been introduced to allow working parents to remain in employment whilst they are bringing up a family.

**Table 12: Females in Employment**[16]

| | Total | | Men | | Women | | Gender gap | |
|---|---|---|---|---|---|---|---|---|
| | 2000 | 2008 | 2000 | 2008 | 2000 | 2008 | 2000 | 2008 |
| EU-27 | 62.2 | 65.9 | 70.8 | 72.8 | 53.7 | 59.1 | 17.1 | 13.7 |
| EA-16 | 61.4 | 66.1 | 71.4 | 73.3 | 51.4 | 58.8 | 20.0 | 14.5 |
| BE | 60.5 | 62.4 | 69.5 | 68.6 | 51.5 | 56.2 | 18.0 | 12.4 |
| BG | 50.4 | 64.0 | 54.7 | 68.5 | 46.3 | 59.5 | 8.4 | 9.0 |
| CZ | 65.0 | 66.6 | 73.2 | 75.4 | 56.9 | 57.6 | 16.3 | 17.8 |
| DK | 76.3 | 78.1 | 80.8 | 81.9 | 71.6 | 74.3 | 9.2 | 7.6 |
| DE | 65.6 | 70.7 | 72.9 | 75.9 | 58.1 | 65.4 | 14.8 | 10.5 |
| EE | 60.4 | 69.8 | 64.3 | 73.6 | 56.9 | 66.3 | 7.4 | 7.3 |
| IE | 65.2 | 67.6 | 76.3 | 74.9 | 53.9 | 60.2 | 22.4 | 14.7 |
| EL | 56.5 | 61.9 | 71.5 | 75.0 | 41.7 | 48.7 | 29.8 | 26.3 |
| ES | 56.3 | 64.3 | 71.2 | 73.5 | 41.3 | 54.9 | 29.9 | 18.6 |
| FR | 62.1 | 65.2 | 69.2 | 69.8 | 55.2 | 60.7 | 14.0 | 9.1 |
| IT | 53.7 | 58.7 | 68.0 | 70.3 | 39.6 | 47.2 | 28.4 | 23.1 |
| CY | 65.7 | 70.9 | 78.7 | 79.2 | 53.5 | 62.9 | 25.2 | 16.3 |
| LV | 57.5 | 68.6 | 61.5 | 72.1 | 53.8 | 65.4 | 7.7 | 6.7 |
| LT | 59.1 | 64.3 | 60.5 | 67.1 | 57.7 | 61.8 | 2.8 | 5.3 |
| LU | 62.7 | 63.4 | 75.0 | 71.5 | 50.1 | 55.1 | 24.9 | 16.4 |
| HU | 56.3 | 56.7 | 63.1 | 63.0 | 49.7 | 50.6 | 13.4 | 12.4 |
| MT | 54.2 | 55.2 | 75.0 | 72.5 | 33.1 | 37.4 | 41.9 | 35.1 |
| NL | 72.9 | 77.2 | 82.1 | 83.2 | 63.5 | 71.1 | 18.6 | 12.1 |
| AT | 68.5 | 72.1 | 77.3 | 78.5 | 59.6 | 65.8 | 17.7 | 12.7 |
| PL | 55.0 | 59.2 | 61.2 | 66.3 | 48.9 | 52.4 | 12.3 | 13.9 |
| PT | 68.4 | 68.2 | 76.5 | 74.0 | 60.5 | 62.5 | 16.0 | 11.5 |
| RO | 63.0 | 59.0 | 68.6 | 65.7 | 57.5 | 52.5 | 11.1 | 13.2 |
| SI | 62.8 | 68.6 | 67.2 | 72.7 | 58.4 | 64.2 | 8.8 | 8.5 |
| SK | 56.8 | 62.3 | 62.2 | 70.0 | 51.5 | 54.6 | 10.7 | 15.4 |
| FI | 67.2 | 71.1 | 70.1 | 73.1 | 64.2 | 69.0 | 5.9 | 4.1 |
| SE | 73.0 | 74.3 | 75.1 | 76.7 | 70.9 | 71.8 | 4.2 | 4.9 |
| UK | 71.2 | 71.5 | 77.8 | 77.3 | 64.7 | 65.8 | 13.1 | 11.5 |

As can be seen from the above Table, the female active labour participation rate between 2000 and 2008 – increased from 33.1% to 37.4% - a percentage increase of 4.3%. Whilst this indicates that the measures introduced had a positive effect, the fact remains that the female employment rate is still low when compared to that of other EU Member states. Indeed, Malta has failed to reach the target established by the Lisbon strategy of a 60% female employment rate by 2010.[17]

The table below shows the distribution of males and females active in the labour market by age.

**Table 13: Employment Rate by Age**[18]

| Age group | Sex | | Total |
|---|---|---|---|
| | Males | Females | |
| | % | % | % |
| | April - June 2010 | | |
| 15-24 | 49.5 | 40.9 | 45.3 |
| 25-54 | 90.0 | 45.8 | 68.5 |
| 55-64 | 48.7 | 12.1 | 30.2 |
| **Total** | **73.5** | **37.5** | **55.9** |

The above Table shows that in the 15 to 24 age cohort, less than 50% of the male and female population are active in the labour market – although males are 9% more active than females. This indicates that a large percentage of the non active participants are continuing with higher education studies.

In the 25 to 54 age cohort, 90% of males and 45.8% of females are active in the labour market. Meanwhile, in the 55 to 64 age cohort – which bridges the retirement age of 61 years – only 48.7 of males and 12.1% of females remain active.

A review of the active female participation rate by age distribution is shown in the Table below.

[16] Pg 20, Labour Market Statistics, Euorstat 2009
[17] EU Labour Force Survey, 2009
[18] Pg 3, Labour Force Survey: Q2 / 2010, National Statistics Office, 30th September 2010

**Table 14: Distribution of Persons Employed by Age**[19]

| Age group | Sex | | | | Total | |
|---|---|---|---|---|---|---|
| | Males | | Females | | | |
| | No | % | No | % | No | % |
| **April - June 2010** | | | | | | |
| 15-24 | 14,854 | 13.3 | 11,398 | 21.1 | 26,252 | 15.9 |
| 25-34 | 29,776 | 26.7 | 19,024 | 35.1 | 48,800 | 29.5 |
| 35-44 | 23,668 | 21.3 | 10,555 | 19.5 | 34,223 | 20.7 |
| 45-54 | 26,607 | 23.9 | 9,095 | 16.8 | 35,702 | 21.6 |
| 55-64 | 14,764 | 13.3 | 3,741 | 6.9 | 18,505 | 11.2 |
| 65+ | 1,644 | 1.5 | 317[u] | 0.6[u] | 1,961 | 1.2 |
| **Total** | **111,313** | **100.0** | **54,130** | **100.0** | **165,443** | **100.0** |

As can be seen from **Table 14**, the proportional presentation of females aged 15-24 years in the labour force is higher than that of males – 21.1% as against 13.3%. This trend is repeated with regards to the 25-34 age cohorts where the proportional presentation of females at 35.1% is higher than that of males.

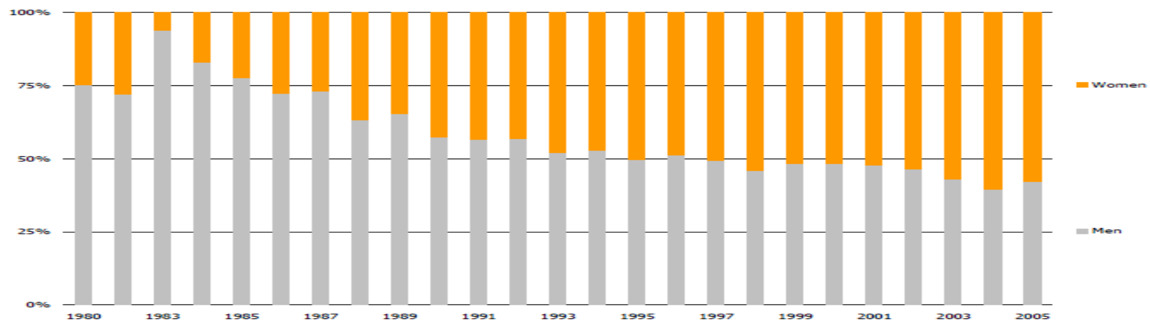
Thereafter, female representation in the labour market falls significantly. The female cohort aged 35-44 years is practically only one-half of the 25-34 years cohort.

The uneven distribution of female representation in the labour market indicates, as will be discussed further, that whilst female participation is increasing amongst the younger female cohorts, amongst the current middle aged and elder generations females seem, in the majority, not to re-enter the market once they would have exited it for child bearing or family responsibilities.

It is pertinent to underline that since 1997, the number of females graduating from the University of Malta has been greater than that of males, as indicated in the Table below. The low female labour participation rate indicates that Malta is not reaping the maximum return in the investment it is making in building human capital with a tertiary education – which comes at high cost.

Whilst the PWG2010 was not able to identify the leakage of female human capital with higher education (that is not only graduates of the University of Malta) that exists in the labour market, it is logical to assume that as the participation rate of females falls from one age distribution to another, the country is experiencing a high loss of female human capital which it can ill afford.

**Chart 18: University of Malta Graduates: 1980 - 2005**[20]




Female participation in the labour market is defined by a particular characteristic: part-time employment. In the 1st Quarter of 2010, female part-time employment stood at 21.9%, compared to 4.6% male part-time employment. In the 2nd Quarter of 2010, female part-time employment stood at 20.1%, compared to 4.6% male part-time employment[21]. It is pertinent to underline that the number of

[19] Ibid
[20] NCPE Graduate Pathway: FIND SOURCE
[21] Pg 8, Labour Force Survey Q1/2010, 30th June 2010 and Labour Force Survey Q2/2010, 30th September 2010, National Statistics Office

females in part-time employment between 2000 to 2008 increased from 15.5% to 25.5 %, as shown in the Table below.

**Table 15: Male and Female in Part-time Employment: 2000 - 2008**[22]

| | 2000 | | | 2008 | | |
|---|---|---|---|---|---|---|
| | Total | Men | Women | Total | Men | Women |
| EU-27 | 16.2 | 6.5 | 28.9 | 18.2 | 7.9 | 31.1 |
| EA-16 | 15.6 | 5.4 | 29.9 | 19.5 | 7.5 | 34.5 |
| BE | 18.9 | 5.5 | 37.4 | 22.6 | 7.9 | 40.9 |
| BG | : | : | : | 2.3 | 2.0 | 2.7 |
| CZ | 5.3 | 2.2 | 9.3 | 4.9 | 2.2 | 8.5 |
| DK | 21.3 | 10.2 | 34.1 | 24.6 | 14.2 | 36.5 |
| DE | 19.4 | 5.0 | 37.9 | 25.9 | 9.4 | 45.4 |
| EE | 8.1 | 5.3 | 10.9 | 7.2 | 4.1 | 10.4 |
| IE | 16.4 | 6.9 | 30.3 | : | : | : |
| EL | 4.5 | 2.6 | 7.8 | 5.6 | 2.8 | 9.9 |
| ES | 7.9 | 2.8 | 16.8 | 12.0 | 4.2 | 22.7 |
| FR | 16.7 | 5.3 | 30.8 | 16.9 | 5.8 | 29.4 |
| IT | 8.4 | 3.7 | 16.5 | 14.3 | 5.3 | 27.9 |
| CY | 8.4 | 4.5 | 13.9 | 7.8 | 4.8 | 11.4 |
| LV | 11.3 | 9.7 | 12.8 | 6.3 | 4.5 | 8.1 |
| LT | 10.2 | 9.2 | 11.1 | 6.7 | 4.9 | 8.6 |
| LU | 10.4 | 1.7 | 25.1 | 18.0 | 2.7 | 38.3 |
| HU | 3.5 | 2.0 | 5.2 | 4.6 | 3.3 | 6.2 |
| MT | 6.8 | 3.0 | 15.5 | 11.5 | 4.5 | 25.5 |
| NL | 41.5 | 19.3 | 71.0 | 47.3 | 23.9 | 75.3 |
| AT | 16.2 | 4.1 | 32.2 | 23.3 | 8.1 | 41.5 |
| PL | 10.5 | 8.2 | 13.4 | 8.5 | 5.9 | 11.7 |
| PT | 10.9 | 6.4 | 16.4 | 11.9 | 7.4 | 17.2 |
| RO | 16.5 | 14.6 | 18.6 | 9.9 | 9.1 | 10.8 |
| SI | 6.5 | 5.3 | 7.8 | 9.0 | 7.1 | 11.4 |
| SK | 2.1 | 1.1 | 3.1 | 2.7 | 1.4 | 4.2 |
| FI | 12.3 | 8.0 | 17.0 | 13.3 | 8.9 | 18.2 |
| SE | 19.5 | 8.2 | 32.3 | 26.6 | 13.3 | 41.4 |
| UK | 25.1 | 8.9 | 44.4 | 25.3 | 11.3 | 41.8 |

The reasons behind the low participation rates of females in the labour market, as well as their high presence in part-time employment are various. In part, there is a strong cultural bias influenced by family patterns and religion for a female to be the full-time family carer.

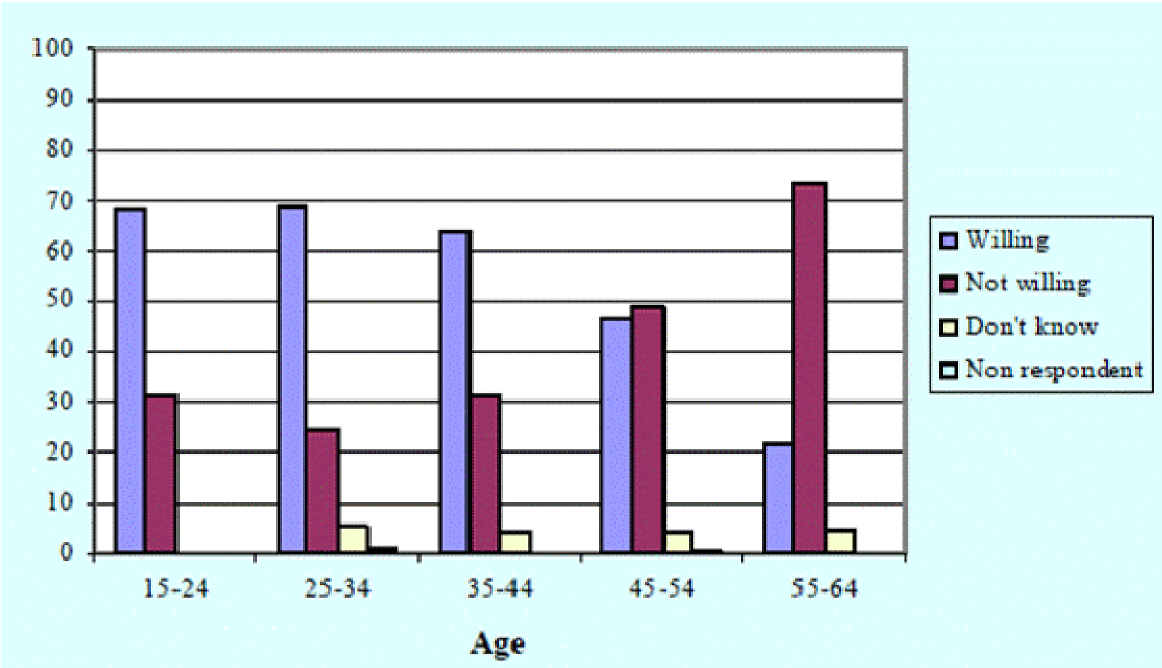
This cultural bias, particularly with regards to females aged 45 years and over who were brought up within a cultural milieu that the husband is the bread winner and the wife is the family carer and child rearer, should not be underestimated. As can seen from the Chart below whilst respondents in the age cohorts between 15 years to 44 years amongst inactive females shows that the overwhelming majority are ready to enter or re-enter the labour market, the perception to willingness to work changes dramatically with regards to females aged 45 to 64 years.

With regards to the 45-54 age cohort females who are unwilling to enter or re-enter the labour market marginally exceed those who wish to re-enter the labour market; whilst with regards to the 55-64 age cohort, females overwhelmingly express an unwillingness to re-enter work.

The above seems to indicates that females who had to resign their employment upon marriage in the late seventies as well as females who never entered the labour market in the first instance are unlikely to enter the labour market irrespective of policy measures introduced to entice them to become active participants.

[22] Pg 24, Labour Market Statistics, Eurostat 2009

**Chart 19: Inactive Females and Willingness to Work**




Source: Employment and Training Corporation, 2007

The impact of the strong cultural make-up particularly with regards to females who are aged 45 years and over should not be underestimated. In essence, this implies that the female labour productivity cannot in the short and medium term grow at a fast rate given that the majority of females in this cohort are unwilling to enter into the labour market once they had exited it for family reasons or have never entered it at the first instance.

Thus, increases in the female participation rate in the immediate and short term are more likely to occur the female cohorts aged 44 and younger. There is no doubt that females within this age cohort – whether this is for reasons of greater independence or greater economic well being for the family – is increasing both in terms of real numbers as well as with regards the periods of remaining in active labour participation.

Nevertheless, as can be seen from Chart 20 below nearly 30% of Maltese female respondents aged 15-39 years are of the opinion that 'women should stay at home and take care of children' – a percentage that follows only Hungary, Estonia, Poland and Latvia and Greece. Moreover, Malta is one of a few countries where the females' perception in this regard is stronger than that of the male.

**Chart 20:"Ideally Women Should Stay at Home and Take Care of Children: By Gender[23]**

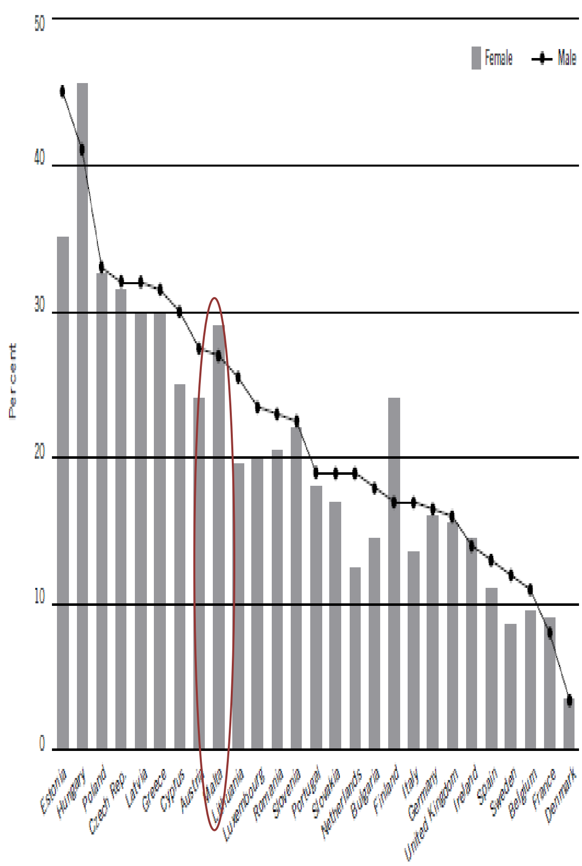
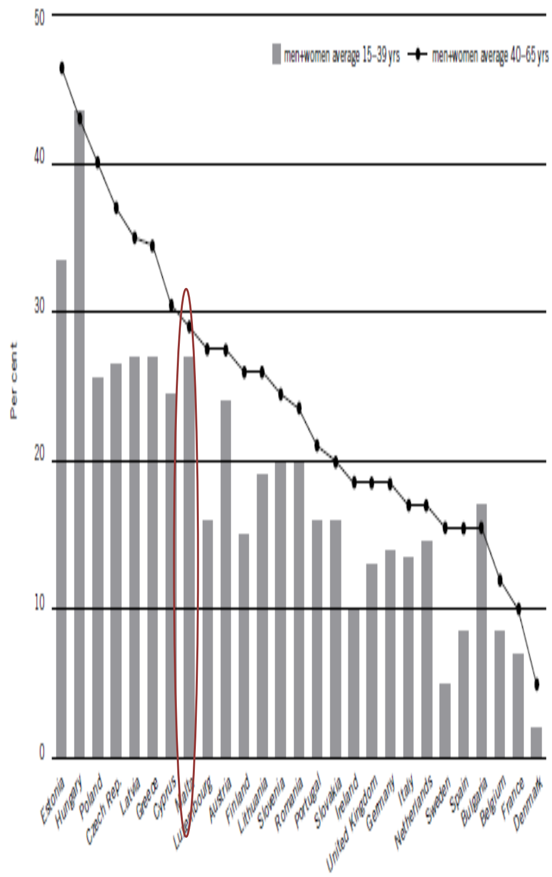



**Chart 21: "Ideally Women Should Stay at Home and Take Care of Children: By Age Group[24]**




One other reason for low female participation in the labour market is that females traditionally assume the role of carers for elderly relatives. In the absence of robust and affordable community care services for the sick, disabled and elderly persons, which is particularly relevant in light of the aging population trend, the pressures on females to assume responsibility for frail elderly relatives will remain. In such an event that such pressures are not alleviated then one other further obstacle will continue to curtail females from potentially taking on paid employment.

## Recommendation 10

The 2010 Pensions Working Group recommends that the Government should continue to strengthen community care support infrastructure for the sick, disabled and elderly persons so as to alleviate the pressure on individuals, particularly females, from the responsibility of care and, consequently, enables them to take on paid employment.

It is to be noted that research shows that the availability of high-quality and affordable child care services is an important factor in increasing female's participation in the labour force.[25] As can be seen from the Table below, working parents in Malta rank amongst the highest amongst EU working parents that do not make more frequent use of child care services.

[23] Pg 34, Gender Equality, Economic Growth and Employment, ASA Lofstorm
[24] Pg 35, Ibid
[25] OECD, Paul Swaim. Women in employment (Microsoft Power Point) [Internet] Available from: http://www.oecd.org/dataoecd/53/52/31457987.pdf.

The Table below shows the use of child care services by females in different employment patterns. The use of child care facilities where both partners are employed is very low, with one of the partners and / or the extended family assuming the responsibility for child care. The high figure of 29 may mean that partners, particularly females, are taking advantage of the paternity breaks introduced as part of the family-friendly package. It is, however, pertinent to remark that, to a large part, long term paternity breaks are predominantly available only in public sector employment.

Where one of the partners has part-time employment, the pattern only changes marginally – a slight increase in the use of child care services and increased dependence on the extended family.

**Table 16: 25 – 49 Aged Couples Child Care Services by Employment Pattern - 2005**[26]

| | Both employed full-time | | | | One employed and one not employed | | | | One part-time and one full-time | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Childcare services | No childcare used | Partner | Relatives | Childcare services | No childcare used | Partner | Relatives | Childcare services | No childcare used | Partner | Relatives |
| BE | 42 | 18 | 11 | 29 | 15 | 8 | 72 | 6 | 36 | 24 | 15 | 25 |
| BG | 24 | 40 | 11 | 25 | 8 | 10 | 76 | 6 | 20 | 36 | 29 | 15 |
| CZ | 24 | 22 | 28 | 27 | 2 | 1 | 96 | 1 | 23 | 14 | 40 | 24 |
| DE | 25 | 27 | 35 | 12 | 4 | 5 | 88 | 3 | 17 | 21 | 47 | 15 |
| EE | 37 | 45 | 7 | 12 | 10 | 23 | 65 | 2 | 42 | 36 | 14 | 8 |
| EL | 37 | 18 | 8 | 37 | 5 | 2 | 90 | 2 | 24 | 16 | 24 | 36 |
| ES | 32 | 27 | 17 | 24 | 6 | 13 | 78 | 3 | 24 | 30 | 26 | 21 |
| FR | 42 | 27 | 10 | 21 | 7 | 8 | 80 | 5 | 35 | 29 | 15 | 20 |
| IT | 23 | 10 | 32 | 36 | 3 | 2 | 89 | 6 | 23 | 10 | 41 | 26 |
| CY | 24 | 20 | 14 | 43 | : u | : u | : u | : u | 13 | 22 | 43 | 22 |
| LV | 40 | 42 | 5 | 14 | 27 | 22 | 50 | 1 | 43 | 32 | 9 | 16 |
| LT | 25 | 47 | 16 | 11 | : u | : u | : u | : u | 18 | 47 | 24 | 11 |
| LU | 43 | 31 | 8 | 19 | : u | : u | : u | : u | 24 | 38 | 15 | 23 |
| HU | 60 | 16 | 3 | 22 | 11 | 2 | 83 | 3 | 51 | 10 | 9 | 30 |
| MT | 4 | 41 | 29 | 26 | : u | : u | : u | : | 5 | 37 | 26 | 32 |
| NL | 31 | 24 | 31 | 14 | 2 | 6 | 91 | 1 | 17 | 20 | 51 | 12 |
| AT | 19 | 14 | 45 | 22 | 6 | 4 | 83 | 8 | 16 | 11 | 49 | 24 |
| PT | 45 | 23 | 6 | 26 | 13 | 24 | 57 | 6 | 21 | 42 | 19 | 18 |
| RO | 15 | 36 | 25 | 24 | 3 | 27 | 59 | 11 | 10 | 30 | 47 | 13 |
| SI | 41 | 20 | 16 | 23 | 12 | 7 | 78 | 3 | 34 | 18 | 17 | 31 |
| SK | 44 | 29 | 8 | 19 | 9 | 7 | 81 | 3 | 29 | 42 | 8 | 21 |
| UK | 30 | 30 | 17 | 23 | 3 | 15 | 79 | 3 | 18 | 31 | 32 | 19 |

Note: DK, IE, PL, FI and SE are missing.

Feedback gathered during the consultation sessions states child care costs in Malta are still unaffordable to many families, especially those with single and / or low income. This situation, combined with cultural norms on the care of children, is leading parents to delegate the responsibility for caring of their children whilst the mother is working to their immediate relatives,

This extended family support network which allows a mother to take up employment whilst her children are looked after by her or her spouse's parents may not be a possible option for future working mothers given that their respective parents themselves may be in employment and hence, informal care will not be as accessible as in the past.

Employers and employees as well as their representatives should work together to design mutually beneficial cost effective mechanisms that will facilitate the ability of female employees to afford child care costs. Initiatives could include the establishment of child care facilities particularly where the aggregate mass of employer and employee presence may render such supporting infrastructure as has in fact happened in certain industrial parks as well as introducing innovative financial incentives such as child care support in lieu of existing traditional ones.

Additionally, the Government and local councils together as well as individually should continuously seek ways to strengthen existing and add new child care infrastructure to increase access as well as affordability.

[26] Pg 72, Reconciliation between Work, Private and Family in the European Union, Euorstat 2009

| Recommendation 11 |
|---|
| The 2010 Pensions Working Group recommends that the Government should consider seeking ways to render childcare facilities in Malta more affordable as well as work with Local Councils so that such programmes are introduced on a locality level to increase accessibility. |

Furthermore, throughout the consultation sessions held with the various constituted bodies representing females, it was universally agreed that a key reason behind the low level of female participation in full-time employment and the high level in part-time employment is the limited presence of Before and After School Care Programmes as well as the frequency and length of school holidays.

The limited presence of Before and After School Care programmes creates an obstacle for female participation as it renders it difficult for a working mother to juggle office start and finishing hours with a school's time table.

The PWG2010 recommends that the Government should seriously study the concern raised by the constituted bodies representing females with regards to the need to introduce Before and After Care school programmes in order for appropriate action to be undertaken to overcome this obstacle to increased female participation in the labour market.

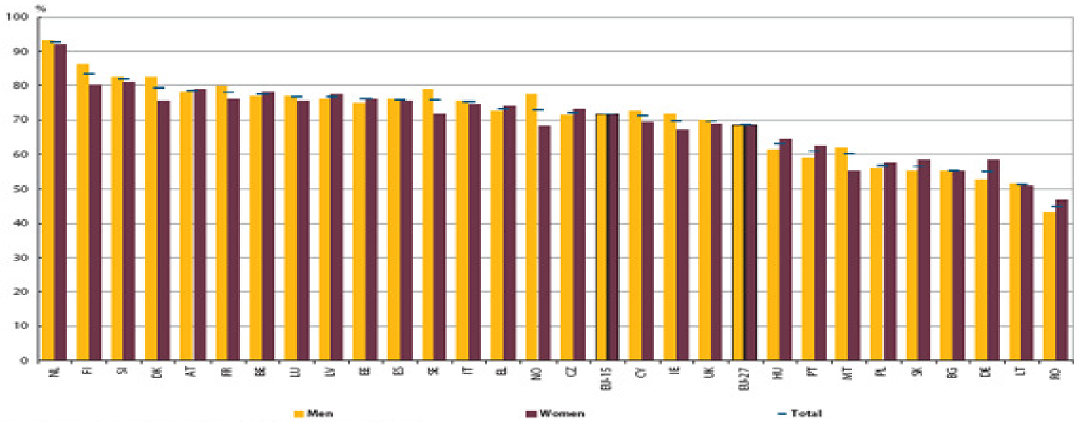
| Recommendation 12 |
|---|
| The 2010 Pensions Working Group recommends that Government should study the concern raised by the constituted bodies representing women with regards to the increased need for Before and After School Care Programmes as the absence of such a support mechanism is seen as an obstacle to increased female participation in the labour market. |

The concept of new job and / or work practices that facilitates a parent's ability to manage both parental and family with professional and employment responsibilities has started to take root in Malta. Two particular new job practices that are effective in this regard are flexi-time work schedules and tele-working.

Whilst it is pertinent to underline that not every job can be designed on the basis of flexi-time work schedules and tele-working principles experiences shows that intelligent organisational re-alignment particularly within the professional, administrative and services industries can result in the re-design of a considerable number of jobs on such principles.

The Chart below shows that whilst inroads have been made in Malta with regards to the introduction of flexitime as a job design principle, it lags behind most of the other EU Member States and the EU 27 average.

**Chart 22: 2006 Employed Persons on Flexi-time[27]**




*Note:* Varying the start or end of the working day by at least one hour

*Source:* LFS and ad hoc Module.

The concept of tele-working as a job design has, with the advent of Malta as an information society, become an accepted principle. Tele-working which allows a person to work from home has increased the ability of females to maintain full-time employment whilst still taking responsibility for the family as this allows them to manage their work commitments around their family responsibilities. Whilst tele-working is not appropriate for all jobs, the Table below shows that Malta, here too, still lags behind EU 27 Member States and the EU 27 average.

**Table 17: 25-49 Aged Population Working Through Tele-working, 2006[28]**

| | Men | | Women | |
|---|---|---|---|---|
| | Usually | Sometimes | Usually | Sometimes |
| EU-27 | 3.8 | 8.4 | 4.9 | 7.1 |
| EU-15 | 4.3 | 9.4 | 5.4 | 7.6 |
| BE | 8.6 | 8.8 | 8.3 | 7.2 |
| BG | 1.9 | 2.5 | 2.0 | 3.8 |
| CZ | 2.5 | 6.3 | 4.2 | 5.0 |
| DK | 2.9 | 28.6 | 4.5 | 21.8 |
| DE | 3.7 | 10.7 | 4.5 | 7.3 |
| EE | 4.5 u | 4.8 u | 4.1 u | 5.5 u |
| IE | 8.2 p | 6.6 p | 4.1 p | 4.3 p |
| EL | 1.0 | 2.4 | 2.2 | 3.5 |
| ES | 2.8 | 2.5 | 2.8 | 2.1 |
| FR | 8.6 | 9.7 | 11.6 | 6.5 |
| IT | 3.7 | 1.8 | 3.5 | 1.3 |
| CY | : | : | 1.0 u | : |
| LV | 2.0 u | 3.5 | 3.2 | 4.4 |
| LT | 1.5 u | 2.2 u | 1.6 u | 3.7 u |
| LU | 5.7 | 1.6 u | 10.1 | 1.1 u |
| HU | 1.7 | 4.5 | 2.1 | 5.3 |
| MT | 3.0 u | 4.4 u | 6.0 u | 6.2 u |
| NL | 5.7 | : u | 5.8 | : u |
| AT | 8.8 | 12.7 | 11.2 | 8.0 |
| PL | 2.2 | 6.8 | 3.0 | 9.8 |
| PT | 0.7 | 4.2 | 1.4 | 2.8 |
| RO | 0.5 | 0.2 u | 0.8 | 0.3 u |
| SI | 3.6 | 6.7 | 7.1 | 8.2 |
| SK | 3.5 | 4.1 | 4.6 | 4.7 |
| FI | 9.9 | 9.5 | 8.9 | 6.6 |
| SE | 2.6 | 11.2 | 2.6 | 6.8 |
| UK | 1.6 u | 26.8 u | 4.1 | 22.5 |
| IS | 11.9 | 27.3 | 10.6 u | 23.9 u |
| NO | 5.5 | 7.8 | 2.9 | 6.1 |
| CH | 2.0 | 12.8 | 6.2 | 13.0 |

It is to be noted that the designation of flexi- as well as tele-working as family friendly measures to which employees have a legitimate right to apply for and avail of if the position they occupy allows this is a policy measure which only the government as an employer has taken – though this does not mean that there are no private sector employers who have introduced such measures.

Although statistics on the uptake of family friendly measures in the private sector are difficult to obtain, 2008 figures for the Public Service indicate that such options still have a relatively low uptake. As seen in the Table below, a total of 203 females opted for family-friendly measures, with 96 choosing flexi-time and 107 tele-working. Male uptake was even lower, with only 71 opting for such measures:

[27] Pg 121, ibid
[28] Pg 128, ibid

**Table 18: Family Friendly Measures in the Public Service, 2008**[29]

| | 2008 | |
|---|---|---|
| | **Females** | **Males** |
| **Flexible Hours** | 96 | 61 |
| **Tele-working** | 107 | 10 |

The introduction and use of new work practices such as flexi-hours and tele-working represent new management principles. Yet, the delegation of authority to management by government as well as private sector employers for the application of such new job practices may not suffice as employee take-up is invariably on the management ethos of the manager to whom an employee is seeking authorisation for the adoption of such a work practice.

For such new practices to truly have an impact on increased female participation as well as the sharing of family responsibilities amongst spouses management must be ready to embrace and encourage take-up of such work practices. Too often, however, such new work practices are seen by management as a 'loss of control' over the staff given that employees are not in their offices within a designated office schedule.

The embracement of such new work practices requires a shift in management philosophy from one directed away from control to one that focuses on productivity. In truth, with the advent of technology, in many positions, particularly within the services and knowledge based sectors, it is irrelevant whether the work is performed from office or home in so far that the work is delivered to the degree of quality expected and the time by which it has to be completed. It is pertinent to underline that in the experience of the members of the PWG2010, the introduction of these new work practices actually lead to an increase in productivity as staff feel trusted and are more often likely to contribute beyond the call of duty.

Whilst Government has been at the forefront leading by example with regards the introduction of flexi-time and tele-working, the efforts in this regard should be complemented by the professional development of public and private sector management with regards to the application and promulgation of such new work practices. Foundation for Human Resource Development should play a leading role in this matter.

**Recommendation 13**

The 2010 Pensions Working Group, whilst acknowledging that Government has been at the forefront leading by example with regards the introduction of flexi-time and tele-working the efforts in this regard, should be complemented by the professional development of public and private sector management with regards to the application and promulgation of such new work practices.

A positive step in encouraging a higher female participation rate is the extension of paid parental leave to 20 weeks which was recently approved by the EU Commission. Indeed, research has predicted that in the prime age cohort (25 – 54 years), female participation rates could go up by a maximum of 9 percentage points following the introduction of this measure.[30]

The low percentage of females active in the labour market could also be the result of the substantial number of women who are opting to work in the black economy. Indeed, research has indicated that *'amongst every 4 Maltese females who declare that they work, there is (at least) a fifth one who works but does not declare it'*[31].

The reasons behind this trend could vary and could include the female working without pay within the family unit e.g. helping the husband in his business, the woman deciding that it is more financially

[29] Ad hoc report prepared by the Ministry for Education, Employment and the Family
[30] Scicluna. E (2010). *The economic impact of parental leave: An evaluation of the benefits and the costs*. IDEAT.
[31] Baldacchino G. (2003). *Factors affecting women's formal participation in the Malta labour market: Results of a research project*. Department for Women in Society, Ministry for Social Policy.

viable to do undeclared work to avoid paying income tax and NI contributions and / or retain their eligibility for social welfare benefits e.g. rent subsidies et al.

For whatever reason, females (and males) must be incentivised to participate in the formal economy, both to boost the economic growth of the country, as well as to ensure that these individuals will have an adequate pension in the future.

The National Council of Women suggests the following measures to encourage more individuals into the formal economy[32]:

i. The creation of a legal and administrative environment which is favourable to the declaration of economic activity and employment, through simplifying procedures and by reducing the costs and constraints which limit the creation and development of business;

ii. Strengthening incentives and removing disincentives to declare work on both the demand and supply sides;

iii. Further incentives to reduce undeclared work e.g. offering a negotiable package of benefits, assistance and obligations;

iv. The setting up of suitable employment policies vis-à-vis beneficiaries of social protection measures to help them to participate in the regular labour market and reduce the risk of unemployment and poverty traps by eliminating undesirable interactions between tax and benefits systems.

The PWG2010 concurs that females (and males) should be incentivised to join the formal economy through the introduction of various measures including, reforming employment regulations, decreasing income tax and NI contributions for part-time and / or low income workers, as well as strengthening the enforcement of undeclared work.

| **Recommendation 14** |
|---|
| The 2010 Pensions Working Group recommends that measures are introduced to incentivise females (and males) to join the formal economy and decrease participation in the black market economy, both to boost the economic growth of the country, as well as to secure adequate pensions for all in the future. |

It is underlined that none of the aforementioned proposals will be successful, unless they are complemented by appropriate redefinition of the cultural and norms with regards to gender roles: moving away from the traditional social model where the male is the bread winner and the female is responsible for the family and child rearing. As discussed above, a substantial percentage of females feel compelled to stay at home and take responsibility for the care of children and elderly relatives. For this reason, Malta needs to develop a more egalitarian family and social model were males take on more responsibility for caring and family duties.

To achieve this aim, the PWG2010 proposes the creation of a national educational campaign aimed particularly at males / fathers to raise awareness on this issue, as well as encourage the social partners to promote more equal sharing of family and / or caring responsibilities between partners. In addition, the egalitarian family and social model must be instilled early on in childhood through the inclusion of this subject in the school curriculum.

[32] National Council of Women. NCW recommendations: The economic crisis, povery, women and work. Paper submitted as pension consultation feedback.

## Recommendation 15

The 2010 Pensions Working Group proposes that a national educational campaign is created which is aimed particularly at males / fathers to raise awareness on a more egalitarian family and social model, as well as encourage the social partners to promote more equal sharing of family and / or caring responsibilities. In addition, the egalitarian family and social model should be instilled early on in childhood through the inclusion of this subject in the school curriculum.

The PWG2010 is confident that the active female participation rate will increase over the projected period. Nevertheless, increases for the reasons discussed earlier, are in the short to medium term expected to be marginal from one year to the other.

Thus, to ensure that policy measures introduced are providing the most optimal results the PWG2010 proposes that the Government should consider carrying out on-going assessment of policy measures introduced to increase female participation in the labour market, so as to gauge their level of success, identify lessons to be learnt, etc as a means to inform future policy making, introduce calibration where necessary and improve future scheme.

## Recommendation 16

The 2010 Pensions Working Group proposes that the Government should consider introducing on-going assessment of policy measures introduced to increase female participation in the labour market, so as to gauge their level of success, identify lessons to be learnt, etc as a means to inform future policy making, introduce calibration where necessary and improve future scheme.

### 04.1.2.3 Labour Participation of Elderly Persons

In January 2008, the Government introduced one important measure that should act as an important catalyst for those persons who were in the transitional and exempt groups respectively when the pension reform was introduced on 1st January 2007: it removed the existing cap on income that a person could earn from retirement up to 64 years of age. In essence, this now means that a person can earn the full retirement pension and remain active in the labour market, whilst retaining the full income earned.

The table below presents male and females who are between 61 and 64 years of age who during the period 2005 and 2010 remained in employment.

The number of persons who continued in employment following the official retirement age increased by 594 persons in 2006 over 2005; and by 317 persons in 2007 over 2006. Following the 2008 reform, 2008 saw an increase of 341 persons on 2007 and 2009 an increase on 2008 of 370 persons. 2010 actually saw a decrease of 174 persons over 2009 – although 2010 presents figures only up to the end of October 2010.

**Table 19: Persons in Employment Aged 62 to 64**

| | Y/A Gender | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | | 2006 | | 2007 | | 2008 | | 2009 | | 2010 | | Grand Total |
| Data | F | M | F | M | F | M | F | M | F | M | F | M | |
| Sum of Employed | 645 | 2,842 | 775 | 3,306 | 897 | 3,501 | 1,019 | 3,720 | 1,136 | 3,973 | 1,171 | 3,764 | 26,749 |
| Sum of Self-Employed | 99 | 624 | 141 | 762 | 140 | 809 | 166 | 942 | 178 | 944 | 158 | 796 | 5,759 |
| Sum of Both | 4 | 118 | 11 | 138 | 13 | 134 | 13 | 160 | 20 | 181 | 13 | 123 | 928 |
| **Total** | **748** | **3,584** | **927** | **4,206** | **1,050** | **4,444** | **1,198** | **4,822** | **1,334** | **5,098** | **1,342** | **4,683** | **33,436** |

Source: Inland Revenue Department (Position as at 19/11/10)

The rate of participation in the labour market of persons who are 65+ years of age is very low – although this has marginally increased between Q1 2005 and Q1 2010. With regards to males this has increased from 0.6% to 1.50% and with regards to females from 0% to 0.70%.

**Table 20: 2005 – 2010 Male and Female Aged 65+ in Employment**

| Q1 2010 | | Q1 2009 | | Q1 2008 | | Q1 2007 | | Q1 2006 | | Q1 2005 | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Male | Female | Male | Female | Male | Female | Male | Female | Male | Female | Male | Female |
| 1,640 | 412 | 1,078 | 49 | 579 | 49 | 664 | 0 | 999 | 229 | 668 | 0 |
| 1.50% | 0.70% | 1% | 0.10% | 0.50% | 0.10% | 0.60% | | 0.90% | 0.50% | 0.60% | 0.00% |

Source: National Statistics Office

Whilst this increase indicates that a shift, albeit a very marginal one, is occurring with regards to retaining persons in employment beyond retirement age, the fact remains Malta is not actively tapping into the valuable experience of elderly people who can still play an active role in the labour market.

A policy measure that should be considered is that of Government assuming the leading role of maintaining in employment persons beyond their official retirement age. As a small nation, positive practices introduced by Government normally have a 'pull' effect on the rest of society. As the nation's largest employer the Government's adoption of an affirmative measure in this regard would strongly signal the importance of this policy measure as well as to induce a shift in the nation's milieu in this regard.

Thus, it is argued that it is important that Government should consider on focusing on the importance of retaining persons post their retirement age, should they still have a valid contribution to make.

The PWG2010 recognises that an affirmative policy position to retain persons past their retirement age has a negative impact on employment opportunities to new entrants in the labour market and potentially promotion opportunities to persons already in the labour market (although this could be mitigated where so necessary by assigning to the elderly person retained in retirement with a different role – such as mentorship, consultancy, et al).

Yet, an affirmative policy position to retain persons past their retirement, as discussed previously in this Report, is also an important mitigating measure that counter-acts Malta's decreasing population and its human capital and skills.

| Recommendation 17 |
|---|
| The 2010 Pensions Working Group recommends that the Government should consider assuming an active affirmative policy to retain beyond the official retirement age employees who can add value and, therefore, acts as the trail blazer in this regard. |

#### 04.1.2.4 Atypical Employment

Careers and work patterns are changing. Whilst traditionally persons sought 40 hour a week full-time employment, there seems to be an increasing shift towards persons seeking a 40 hour a week employment where work is carried out with more than one employer.

This is a trend that reflects employment pattern evolution in economies with high value added sectors. Persons with the appropriate skills in such sectors are able to leverage a better return on their skills investment by assuming assignment based work – particularly if a particular sector has a skills deficit.

In the ICT industry, job design in many instances is no longer solely based on a 40 hour week full-time employment, but also on a job-sharing basis where the required 40 hour a week work required for a particular task is shared by more than one person.

As can be seen from the Table below, part time employment increased by 24% over a five year period.

**Table 21: Part-Time Employment 2005 - 2009**[33]

| | Dec-05 | Dec-06 | Dec-07 | Dec-08 | Dec-09 |
|---|---|---|---|---|---|
| Labour Supply | 146,012 | 147,518 | 149,266 | 151,891 | 151,507 |
| Employed | 138,633 | 140,357 | 143,094 | 145,518 | 143,827 |
| Direct Production | 42,309 | 42,636 | 41,792 | 40,456 | 38,330 |
| Market Services | 95,509 | 96,988 | 100,603 | 104,351 | 104,855 |
| Temporary Employed | 815 | 733 | 699 | 711 | 642 |
| Part-Time Employment | 39,263 | 42,115 | 45,235 | 47,090 | 49,736 |
| Unemployed (part I & II) | 7,379 | 7,161 | 6,172 | 6,373 | 7,680 |
| Unemployment rate (%) | 5.1 | 4.9 | 4.1 | 4.2 | 5.1 |

The current pension system does not support atypical employment. A person who is employed part-time in more than one job only pays one national contribution on the job which provides the highest income. This has two impacts. First, the employer who provides the least paying job does not contribute to the person's National Insurance contribution.

Second, and perhaps more significantly, a person who decides to assume an atypical career path will never be in a position to receive a full pension upon retirement.

The PWG2010 is of the considered opinion that the current provisions in the law are anachronistic given that they do not reflect emerging employment patterns. Thus, the PWG2010 recommends that the Government should, with effect from 2011, reform this aspect of the SSA in order 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.

**Recommendation 18**

The 2010 Pensions Working Group recommends that the Government should consider to reform in 2011 the provisions in the Social Security Act relating to part-time work 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 on an atypical basis – that is, irrespective of the number of employers the person is engaged with.

### 04.1.3 Adopting a Targeted Immigration and Residency Policy

In the event that a holistic framework of pro-natal policies fails to revive the birth rates to levels that will counter the projected phenomena of an aging and decreasing population, Malta should seriously consider the introduction of a targeted immigration and residency policy directed to revitalise Malta's population – and in doing so mitigate to some degree the demographic risk to the sustainability of the PAYG First Pension.

The PWG2010 understands that a targeted immigration and a residency policy is a sensitive subject. The PWG2010 also understands that an active targeted immigration and residency policy will bring into play a unique set of challenges as a previous homogenous society would have to learn to live with and accommodate a heterogeneous population made up of minorities with different beliefs, norms and cultures.

[33] Pg 30, Pre Budget 2011: Ideas, Vision, Discussion, Ministry of Finance, the Economy and Investment, July 2010

Yet, economic theory recognises that the size of the population and the skill level of the human capital are key attributes for economic growth. Whilst, innovation, technology and arising efficiencies can compensate for a reduction in the size of the population and in the skill level of the human capital available there is a limit to the extent that these can stem the demand of skills required and the skill scarcity that will arise in particular sectors and hence the corresponding negative impact on sectorial economic growth.

It is pertinent to underline that Malta's state of play in this regard is not unique. Europe's demographic situation is characterised by increased longevity and low fertility. This has lead to population aging and eventually shrinking domestic populations and work forces. Given the high levels of employment already reached by skilled EU-nationals, recruitment of migrants from third countries is increasingly appearing as the main way of responding to the growing demand for medium and high skilled labour. At the same time, Europe experiences a continuing demand for low skilled labour. For these demographic and economic reasons, during the 21st century, all present EU and EEA member states and EU candidate countries are expected to either remain or become immigration countries[34]:

> "After 2010, many [EU] countries will have to develop pro-active migration policies to meet burgeoning demographic and economic needs. For a relatively short period of time, European East-West migration will continue to play a role. But in the medium and long term, potential migrants will inevitably be recruited from other world regions. In this context, Europe will have to compete with traditional countries of immigration — in particular Australia, Canada, and the USA — for qualified migrants to fill labour gaps. The main challenge will be to put Europe in a position that allows the EU and its member states to actually attract and recruit migrants matching EU labour market needs and to sustain economic growth as well as support for the public pension system. In this context a pro-active approach to immigration can play a crucial role in tackling shortages of labour and skills, provided the qualifications of immigrants are appropriate."[35]

It is pertinent to note that, in absolute terms, Germany has by far the largest foreign-born population (10.1 million), followed by France (6.5 million), the UK (5.6 million), Spain (4.9 million) and Italy (2.5 million). Relative to population size, two of Europe's smallest countries – Luxembourg (37.4 percent) and Liechtenstein (33.9 percent) – have the largest stock of immigrants, followed by Switzerland (22.9 percent) and two Baltic States (Latvia 19.5 percent and Estonia 15.2 percent), Austria (15.1 percent), Ireland (14.1 percent), Cyprus (13.9 percent), Sweden (12.4 percent) and Germany (12.3 percent). In the majority of West European countries, the foreign-born population accounts for 7 – 15 percent of total population. In Central Europe (with the exception of Slovenia), the share of foreign-born is still below 5 percent.[36]

EU and EEA citizens are more or less free to move within Western and Central Europe, to take residence and to join the work force in any other EU and EEA member states. Certain restrictions still apply to citizens of new EU Member States in Central Europe (EU 10) seeking employment in another EU country. The transitional regime limiting the free movement of workers from new member states (except Cyprus and Malta) following enlargement of the European Union on May 1, 2004 and January 1, 2007 allows other EU countries to decide to postpone the opening of their national labour markets up to a maximum period of seven years. Initially only three countries, the UK, Ireland and Sweden had opened their labour markets to newly arriving EU citizens from Central Europe and the Baltics. In 2006 - 2007 Finland, Greece, Italy, the Netherlands, Portugal and Spain followed their example. Since 2007 a similar transitional regime limits the free movement of Bulgarian and Romanian workers. So far only a few EU countries (including the Czech Republic, Estonia, Finland, Poland, Slovakia and partly France) have opened their labour markets for workers from Bulgaria and Romania.[37]

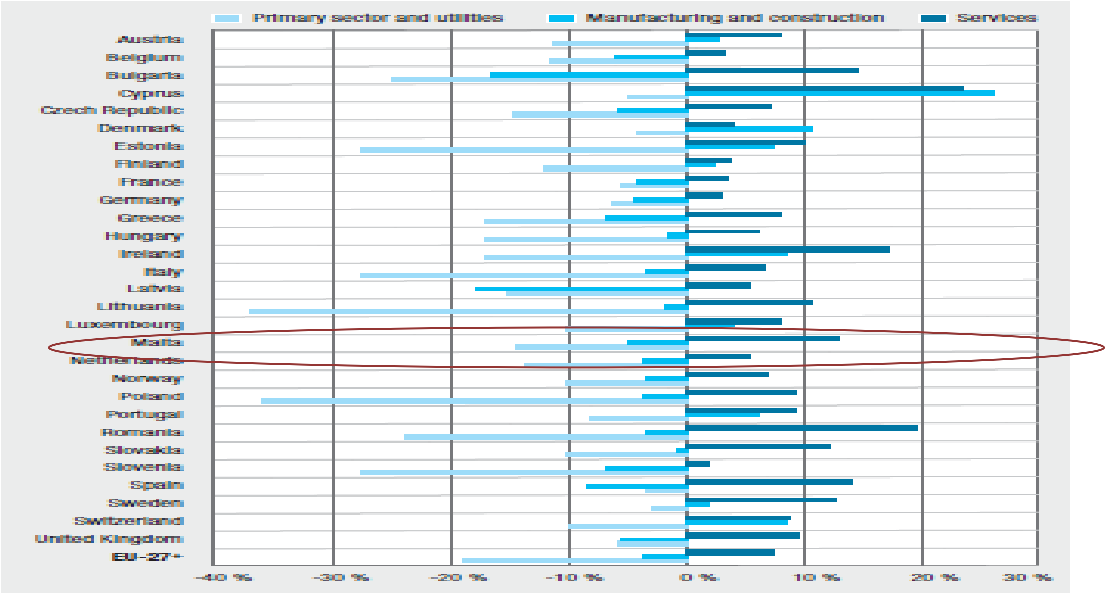
The key gates of entry for third-country nationals immigrating to the EU are temporary and long-term labour migration, family reunion and family formation, the inflow of asylum seekers (some 350,000

[34] Pg ii, Munz, R., Migration, Labour Markets, and Integration of Migrants: An Overview for Europe, Social Protection and Labour, The World Bank, April 2008
[35] Pg 17, Ibid
[36] Pg 4, Ibid
[37] Pg 6, Ibid

applications in EU in 2005), and the inflow of coethnic "return" migrants and their dependent family members.[38]

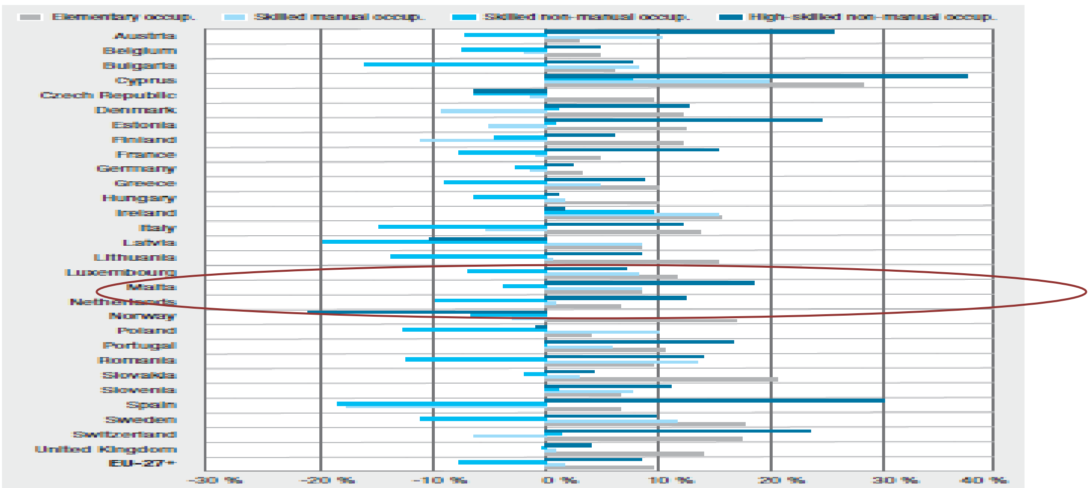
In the course of carrying out its work, the PWG2010 came across three skills' supply and demand studies that relate to Malta. The first study is a skills supply and demand medium term forecast for Europe carried out by CEDEFOP. The study shows that between the period 2010 to 2020 the employment market in Malta will experience an increase in the services sector at the expense of the primary sector, utilities, manufacturing and construction sectors respectively. This is shown in **Chart 23** below.

**Chart 23: Projected Change in Employment in Broad Sectors By Country: 2010-20 (%)[39]**




Moreover, as shown in **Chart 24** below, the projected change in occupational structure will occur in elementary occupation, skilled non-manual occupation, and the highly skilled not manual occupation.

**Chart 24: Projected Change in Occupation Structure By Country: 2010-20 (%)[40]**




The study further shows that overall, the period between 2010 to 2020 will see the creation of 11,000 new employment jobs. The high qualification sector will increase by 25,000 new jobs and the medium

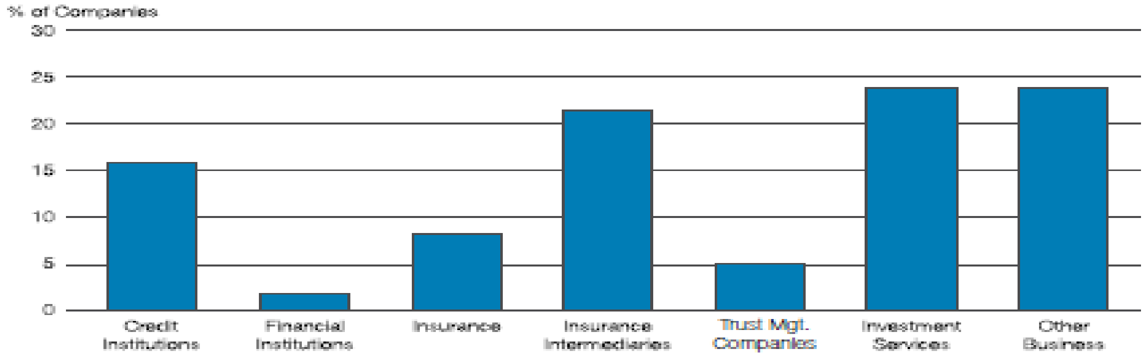
[38] Pg7, Ibid
[39] Page 65, Skills Supply and Demand in Europe: Medium-Term Forecast Up to 2020, European Centre for the Development of Vocational Training, European Union, Luxembourg, 2010
[40] Pg 66, Ibid

qualification sector will increase by 17,000 new jobs while the low qualifications sector will contract by 31,000 jobs.[41]

In essence, this means that in the period 2010 to 2020, the Maltese employment market is forecasted to grow in medium and high skilled valued added employment. Whilst a number of these jobs should be filled from persons occupying jobs in the low qualifications sector by means of re-skilling and training, there will be, nevertheless, a swath of jobs that would have to be filled either by current market participants or new participants. A situation, however, may arise where the level and quantity of the human capital required may not be readily available in Malta in the immediate term.

A skills audit carried out by the MFSA in August 2008 shows that 54% of the vacancies at the time the audit was carried out were defined as 'hard to fill vacancies'. Skill gaps were identified in the following sub-sectors within the financial services sector.

**Chart 25: Presence of Skill Gaps by Sub-Sectors[42]**

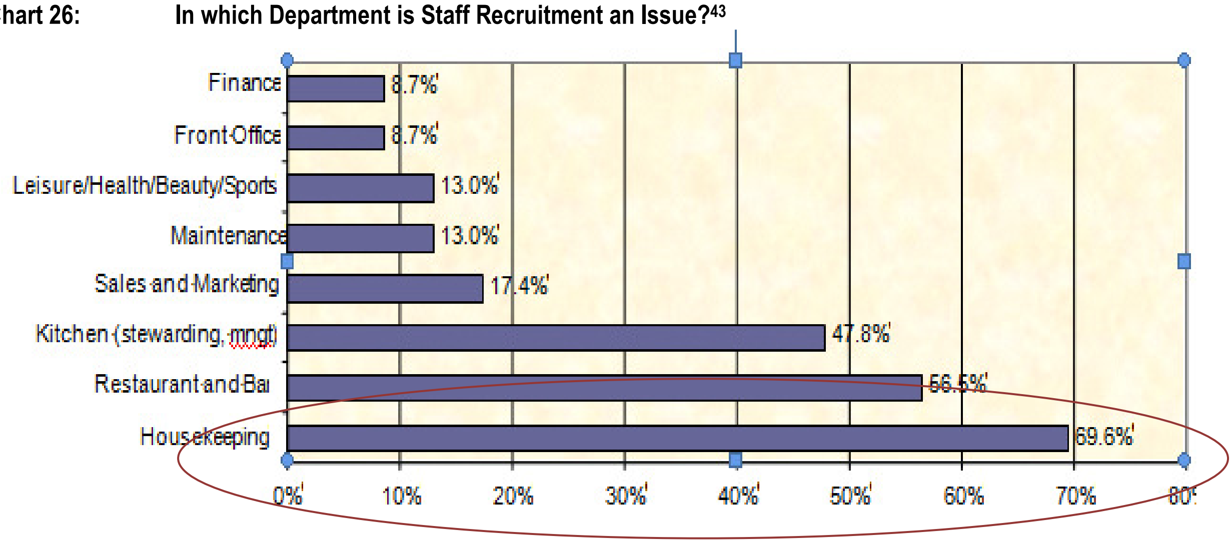



The report, thus shows, that the financial services sector – which is at the high end of the skilled non manual occupational sector will find it challenging to expand unless the current skills gaps are addressed through indigenous capital development or re-skilling and if this is not possible the importation, in part or in full, of the necessary human capital..

A study carried out by the Malta Tourism Authority in 2001 titled 'Skills Analysis and Employment Forecasts for the Maltese Tourism Industry' shows that the hardest jobs to fill in the accommodation industry are within the Restaurant and Bar, and the Housekeeping Departments respectively.

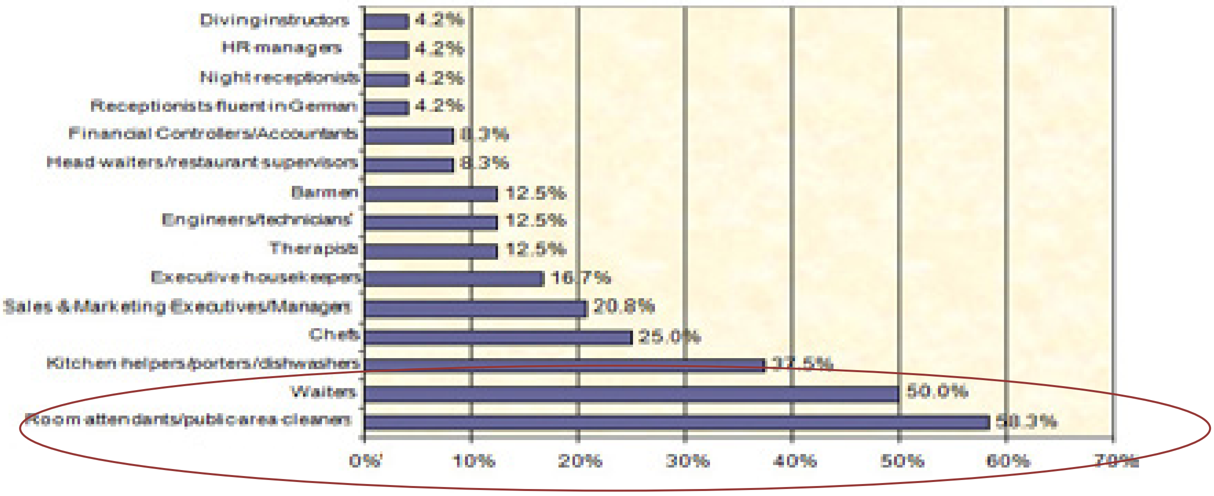
[41] Pgs 100 – 101, Ibid
[42] Pg 26, Building on Success: Future Skills Requirements in the Financial Services Sector, Malta Financial Services Authority, August 2008

**Chart 26: In which Department is Staff Recruitment an Issue?**[43]




Of particular note, however, is the fact the recruitment issues arise with regards to low level positions such as room attendants / public area cleaners; waiters; and kitchen helpers / porters / dishwashers.

**Chart 27: For What Position?**[44]




The above two surveys – one targeted at a 'new' sophisticated market and the other at a 'traditional' mainstay sector of the economy both suffer from difficulties to employ the right persons with the right level of skills – even though the skills levels sought by either sector stand at different poles of the skills matrix.

There is no doubt that Malta must continue to invest in education and human capital development targeting both high value added skills as well as targeting skills gaps where these exist. Yet, a decreasing aging population will, at least over the long term, undoubtedly constraint Malta's ability to plug all skills gaps as they occur.

The PWG2010 is, therefore, of the considered opinion that the Government should revisit its current immigration and residency policy. Within the context of EU immigration and residency legislation, the PWG2010 recommends that the Government should seek to adopt a selective immigration and residency policy directed to target persons who have the appropriate skills levels that the local economy is not in a position to provide in order to engender continued economic growth.

[43] Pg 13, 'Skills Analysis and Employment Forecasts for the Maltese Tourism Industry, Malta Tourism Authority, June 2001
[44] Ibid

Whilst a targeted immigration and residency policy may serve as a vehicle that can assist in revitalising the Maltese population its primary significance arises from the fact that as a policy tool it will expand the contributory base of the First Pension as well as serve as an economic tool that will enable further growth and expansion of those economic sectors whose growth is or may become constrained due to arising skills deficits in different sectors of the local economy.

| **Recommendation 19** |
|---|
| The 2010 Pensions Working Group whilst noting that Malta should continue to invest heavily in education to build its indigenous human capital recommends that the Government should consider a targeted immigration and residency policy to narrow skills deficits and inadequate labour supply that is or may constrain the economy from growing further and where short run solutions on the labour domestic market are unlikely to give the desired results – and in doing so increasing the contributory base of the First Pension. |

## 04.2 Recommendations for Consideration to Strengthen the Sustainability, Adequacy and Solidarity of the First Pension

The PWG2010 invited the assistance of the WB to carry out on its behalf an actuarial assessment of the current strength of the First Pension as well as its projected future behaviour. Supplementary Paper 05 provides the full report on the actuarial assessment carried out by the WB.

It is pertinent to underline that the First Pension – that is, the National Insurance Contributory Pension – covers three forms of pensions: retirement; survivors; and invalidity pensions.

The assessment and modelling was based on the following parameters:

(i) The First Pension system as at the time of the study – thereby incorporating the reforms carried out on both the National Insurance contributory retirement pension in 2007 and the invalidity pension in 2008.

(ii) The Aging Working Group macro-economic assumptions as already discussed in Chapter 03.

(iii) The contribution revenue accounted in the assessment and modelling is based as defined by the SSA in terms of:

> Class One Contribution:
>
> "7(1) For every person who is employed in insurable employment, three contributions per week shall be payable in accordance with the provisions of this Act, one by the employed person, one by his employer, and one out of the Consolidated Fund ...".[45]
>
> Class Two Contributions:
>
> "10(2) For every contribution payable by a self-employed or self-occupied person under this Act, another contribution shall be payable out of the Consolidated Fund".[46]

It is pertinent to underline that the inclusion of the State contribution from the Consolidated Fund is a ***departure*** from the modelling carried out in 2004 and 2005 where the State contribution was not accounted in the revenue stream.

[45] Pg 13, Social Security Act, Chapter 318, http://justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=8794&l=1
[46] Pg 15, Ibid

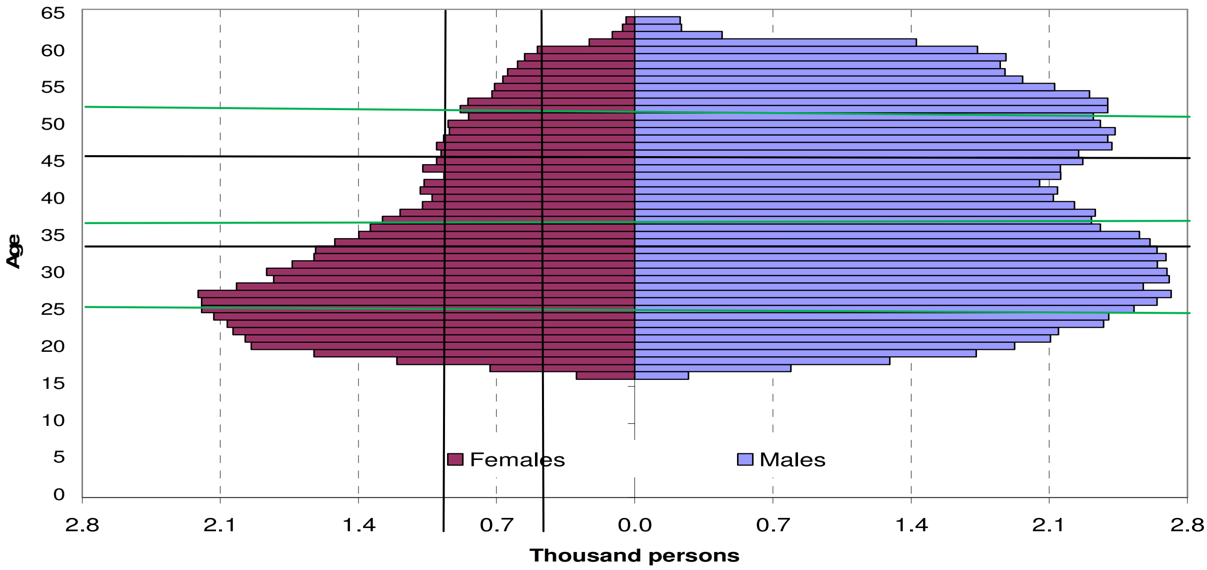
In discussions held with the WB the conclusion reached by the PWG2010 was that an actuarial assessment of the health of the pension system with regards both to its level of adequacy and its sustainability would be flawed if this assessment is not based on the First Pension system *as established by the legislation* that governs and regulates the said Pension system.

In 2009, the number of contributors to the First Pension stood at approximately 159,000[47]. The mean age stands at 37 years, with male contributors constituted 74% of the contributors' population. As can be seen from the Chart below the total maximum number of female contributors' peaks at around 28 years of age at approximately 22,000 active female participants.

Thereafter the number of female contributor's falls gradually until it stabilises at approximately 10,000 contributors for every age cohort between 39 years of age to 54 years of age. After 54 years of age, the number of female contributors continues to constrict further until it reaches a population of 6,000 active female participants prior to retirement age.

Of particular interest is that the cohort of male contributors between the 36 and 47 age cohorts falls considerably to a low of approximately 19,000 contributors at the 43 age cohort when compared to the 47 and 55 age cohorts respectively which stand at approximately 24,000 contributors within each age year and the 26 and 36 age cohorts respectively which stand at approximately 26,000 contributors within each age year.

**Chart 28: Contributors to the First Pension - 2009**

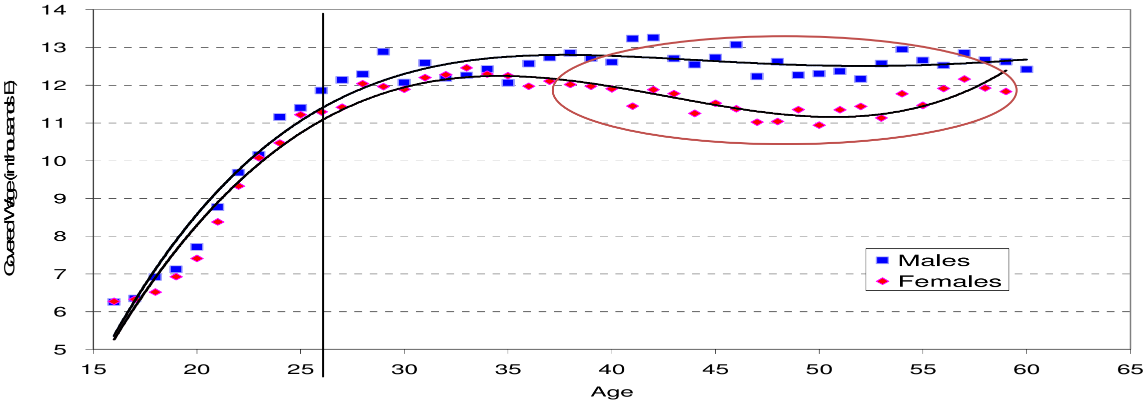



Source: World Bank Actuarial Report, November 2010

The Chart below shows the difference in basic wage between male and female contributors. Of particular note is that between the ages of 15 and 26 years of age the gender pay gap is respectively small and although this starts to grow between the age of 27 and 36 years of age the gender pay gap still remains relatively low. Nevertheless the gender pay gap increases substantially thereafter, peaking with the 50 year old female cohort and thereafter the gap narrows significantly reaching quasi parity.

[47] Pg 8, World Bank Actuarial Report, November 2010

**Chart 29: Covered Wage by Age and Sex - 2009**




Source: World Bank Actuarial Report, November 2010

**Table 22** below categorises the number of pensioners within the First Pension. The number of Retirement pensions stands at 52,656 – which constitute 69% of the total number of contributors covered by the First Pension in 2009.

The mean age for retirement pensioners is 69.6 years of age – which although somewhat inflated due to a ¼ female pensioner cohort – is substantially lower to the 73.9 mean age of survivor pensioners who are female pensioners – reflecting the trend that females have a higher longevity than males. The proportion of female pensioners on retirement pension is 26.1% which reflects the low level of female participation in the labour market to date.

The actuarial study shows that the median level of adequacy of the retirement pension when compared to the average salary as at 2009 stands at 54.7%.

The 53.7% median pension replacement rate of the survivor pension compared to the 54.7% of the retirement pension seems to indicate that survivor pensioners are not, on a median basis, worse off than retirement pensioners.

**Table 22: Classification of Beneficiaries of First Pension and Replacement Rate**

| Group of Pension | Cases | Mean age | Proportion female | Mean annual payment | Median annual payment | Replacement Rate (on total average salary) |
|---|---|---|---|---|---|---|
| Retirement | 52 656 | 69,6 | 26,1% | 6 836 | 6 755 | 54,7% |
| Widow | 16 165 | 73,9 | 99,2% | 6 874 | 6 626 | 53,7% |
| Invalidity | 7 499 | 56,0 | 25,4% | 5 246 | 5 672 | 46,0% |
| **Total** | **76 320** | **69,2** | **41,5%** | **6 688** | **6 621** | **53,6%** |

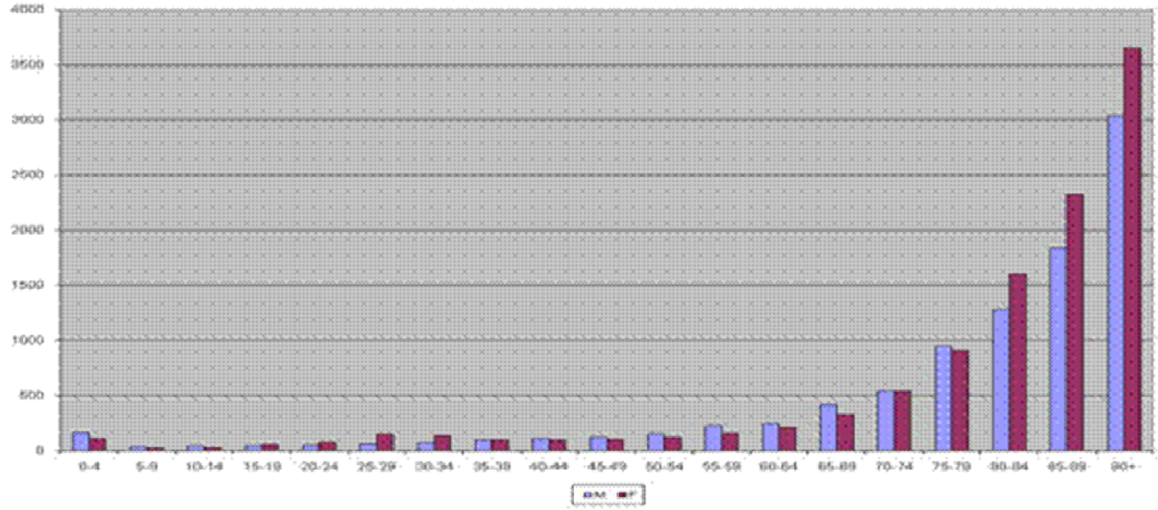
Source: World Bank Actuarial Report, November 2010

The retirement pension is complemented by a broad social security framework that provides a wide range of universal, co-paid or means tested benefits to retirees to help with a variety of expenses. Most of these additional benefits provide assistance for specific needs which are either particularly relevant for retirees or because retirees being on fixed pension income are less able to as effectively respond to fluctuations or large one off costs such as increases in energy prices as the working population as a whole.

One example of a universal benefit is health care that is clearly an area where the elderly are more likely to be greater recipients. Indeed, as can be seen from the Chart 31 below the cost of health increases at an exponential rate with regards to persons who are aged 65 years and over.

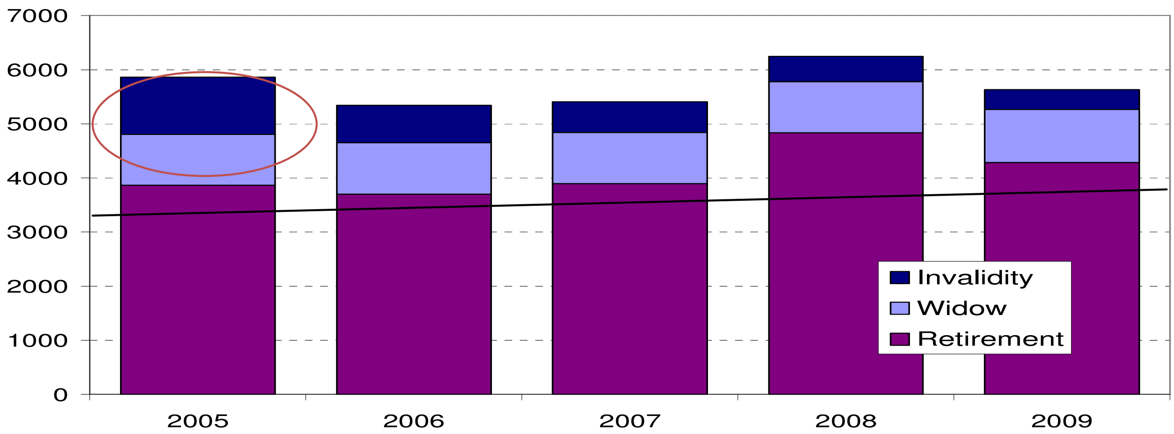
A further example is the provision of long term residential care which is on the basis of co-payment. Means tested benefits provided to pensioners include pharmaceutical entitlement whilst other services include assistance from the Housing Authority to allow pensioners to remain in their home, community can home care support services, transport subsidies, et al.

**Chart 30: Average Cost of Institutional Health - 2009**[48]




The number of annual First Pension beneficiaries between 2005 and 2009 was an average of 5,698. As expected the high number of new beneficiaries related to retirement pensioners – which is on an increasing trend even though the 2008 pensioner cohort was relatively higher than that in 2009.

**Chart 31: New First Pension Beneficiaries: 2005 - 2009**




Source: World Bank Actuarial Report, November 2010

The number of invalidity pensioners decreased considerable between 2005 and 2009 –showing that the reforms introduced to the invalidity pension in 2008 have been successful in curbing potential abuse that would result in an early exit from the labour force.

As can be seen from the Table below, the First Pension Account – factoring also the State's contribution from the Consolidated Fund to Class I and Class II contributors respectively – is in a positive balance up to 2009 had, however, *the total contributory revenue been ring fenced for social security purposes only.*

[48] Ad hoc report by the Ministry of Health, Elderly and Community Care

**Table 23:** **State of Account of First Pension**

| | Concept | 2007 | Year 2008 | 2009 |
|---|---|---|---|---|
| 1 | Social Security contributions | 320 | 340 | 351 |
| 2 | Direct contribution SSA 1987 | 160 | 170 | 175 |
| 3 = 1+2 | **Total Revenue (Contributions)** | **480** | **510** | **526** |
| 4 | Invalidity | 37 | 35 | 32 |
| 5 | Retirement | 262 | 294 | 320 |
| 6 | Bonus | 29 | 33 | 39 |
| 7 | Widows (Survivorship) | 90 | 94 | 98 |
| 8 | Short term | 13 | 13 | 14 |
| 9 | **Total Contributory Benefits** | **431** | **469** | **502** |
| 10 = 3-9 | **Current balance** | 49 | 41 | 24 |
| 11 = 10/3 | Relative surplus | 10.2% | 8.0% | 4.5% |

Source: World Bank Actuarial Report, November 2010

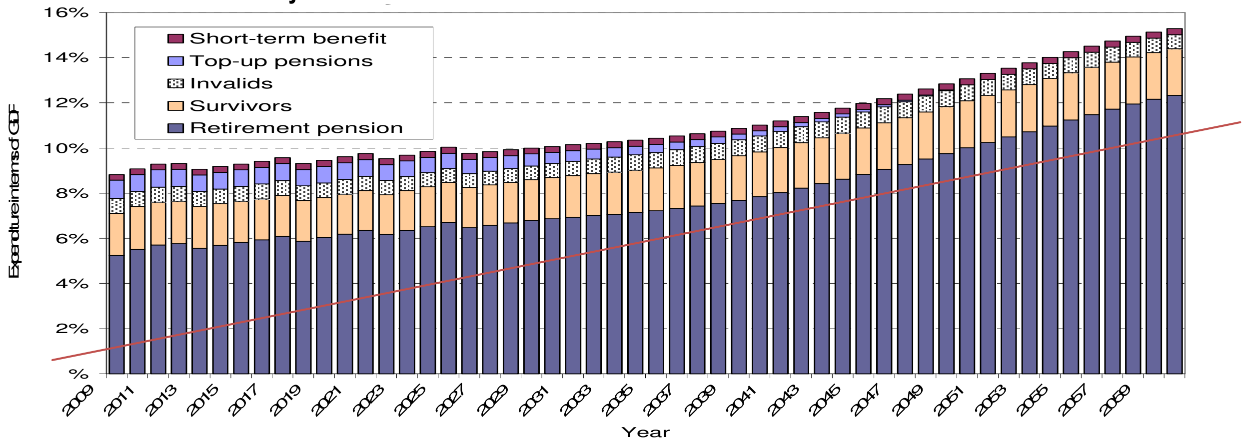
As discussed in the previous Section of this Chapter demographic trends are significant determinants of the projected financial flows of the First Pension system. It so follows, that as the population ages, the labour market contracts as people live longer and new entrants get smaller, the deficit of the First Pension system will grow larger, and therefore, the sustainability of the pensions system will increasingly become more vulnerable.

The increasing number of beneficiaries implies a significant growing trend in the payment of pensions in terms of GDP – increasing from 8.8% in 2009 to 15.3% in 2060. It is important to re-emphasise that this result is influenced by the macro-economic assumption of conservative GDP behaviour over the said period as established by AWG and explained in Chapter 3 of this Report.

As can be seen from the Chart below, the primary determinant on this anticipated increase in benefit payments is the retirement pension benefit. This will increase from approximately 5% in 2009 to approximately 12% in 2060 – a 140% increase.

The Top-Up pension provision is expected to be phased out by 2047 whilst the short term benefits and the Invalidity and Survivor pensions respectively are expected to remain stable over this period.

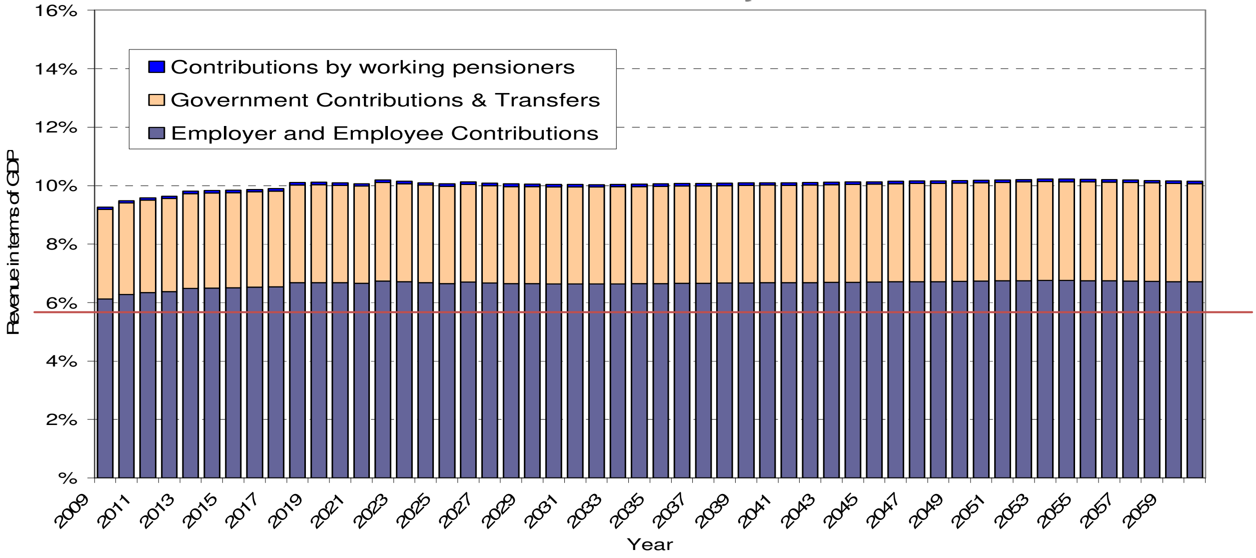
**Chart 32:** **Benefit Payments in Terms of GDP for the Period 2009 – 2060**




Source: World Bank Actuarial Report, November 2010

On the other hand, the contribution revenue of the First Pension system is expected to remain stable over the same period as is shown in the Chart below.

**Chart 33: Total Revenue of the First Pension System for the Period 2009 – 2060**



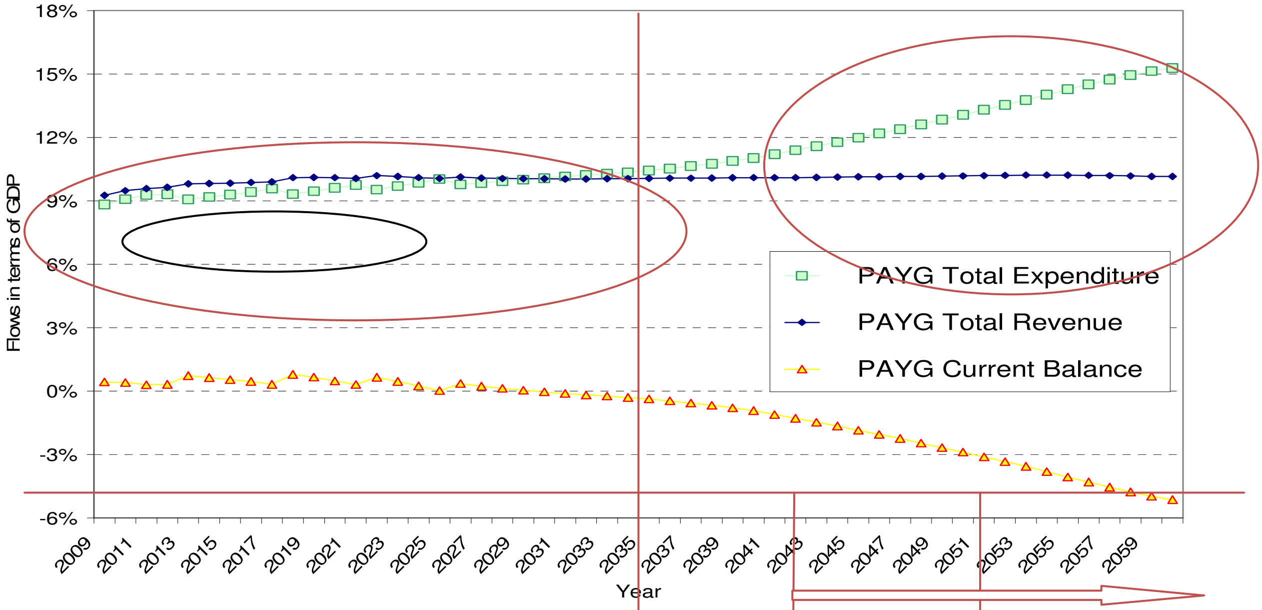

Source: World Bank Actuarial Report, November 2010

As can be seen from the Chart below which reconciles the revenue and payment flows of the First Pension System for the period between 2009 and 2060 the First Pension System balance of the said Account is expected to be in equilibrium between 2014 and 2031.

Be that as it may, however, the First Pension System is expected to go into deficit in 2032 and thereafter the deficit, due to the significant changes to the demographic profile of Malta, will increase exponentially relative to GDP.

Thus, from a slight deficit in 2035 the deficit of the First Pension Account relative to GDP will increase to (3%) by 2051 and within a period of 9 years practically double to a deficit of (6%).

**Chart 34: Balance of the First Pension Account for the Period 2009 - 2060**




Source: World Bank Actuarial Report, November 2010

It is to be noted, however, that a First Pension System has never actually been set up in Malta – as contributory revenue generated by the First Pension system since its introduction in 1979 has been used for the financing of health, non-contributory benefits, et al.

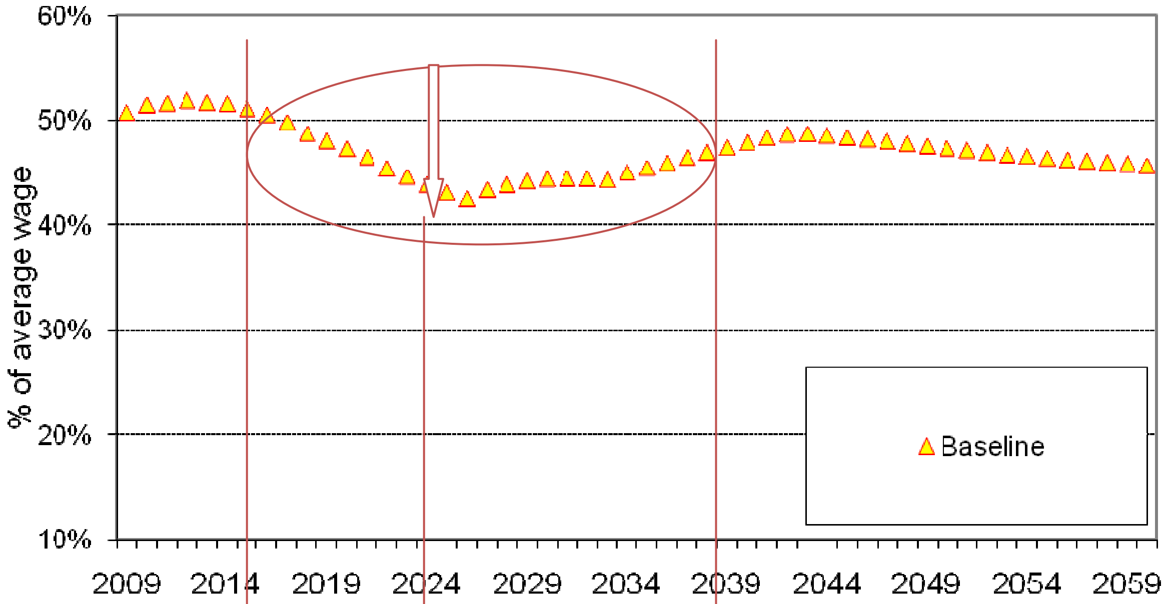
It is pertinent to underline that the PWG2010 is recognisant of the fact that the PWG in its Final Report in June 2005 had recommended that:

> "... Government should create separate Accounts or Funds for pensions, health, and non contributory benefits with clear non-subsidised financing mechanism across them – thereby introducing a framework that allows financing to be transparent, managed and controlled ... where revenue collected from contributions paid is retained for pension purposes and cross-subsidisation is terminated...".[49]

As is discussed later in this Chapter, the PWB2010 recommends that the Government should consider undertaking a detailed assessment of whether Malta's First Pension should be reformed into a Notional Defined Contribution First Pension system. In the event that this concludes that Malta should retain its current PAYG framework than the PWG2010 is of the considered opinion that the Government should consider studying the option of setting up a ring fenced pension account for the First Pension.

The modelling carried out by the PROST simulation took shows that the projected average pension replacement rate is expected to be slightly over 50% of average wage between 2010 and 2015. Thereafter, the average pension replacement rate will start to drop until 2025 where-in it reaches 42% of average wage before it starts to increase again until in peaks in 2040 to 49%. Once again, thereafter, the replacement rate starts to drop again reaching 45% of the average age in 2060.

**Chart 35: Average Pension Replacement Rate for the Period 2009 to 2060**

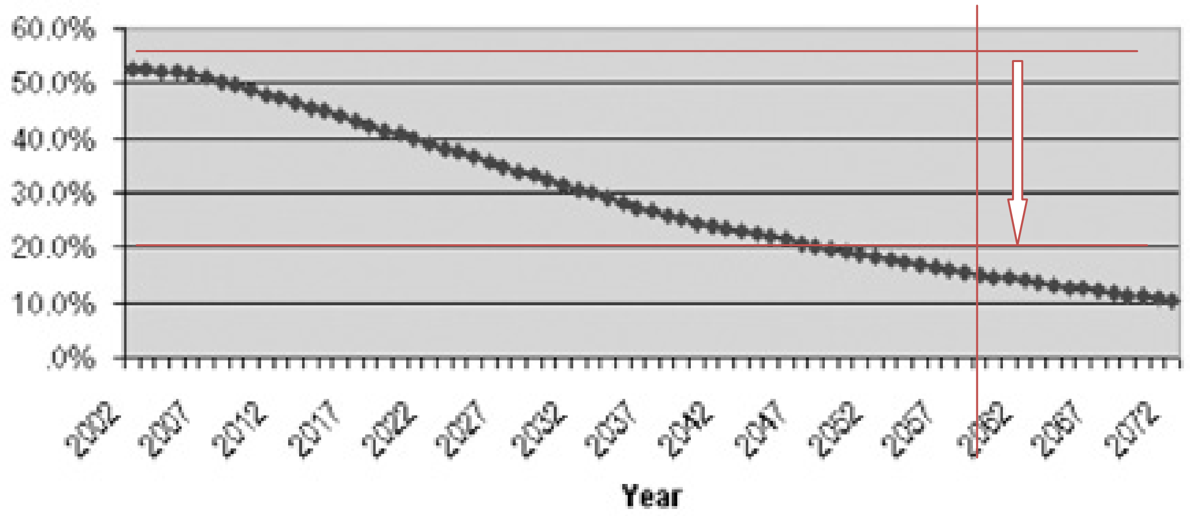



Source: World Bank Improving Sustainability of the Current Pension Scheme: Alternative Scenarios, Report, November 2010

It is pertinent to emphasise that the average pension replacement rate shown above would have been far lower if the parametric reforms to the First Pension introduced in January 2007 where not introduced. As shown below, in the absence of the parametric reforms, the average pension replacement rate in 2060 was expected to be 18%.

[49] Pg 37, Pensions Working Group, Pensions Adequate and Sustainable: Final Report, 30th June 2005

Chart 36: Average Pension Relative to Wage on 2004 Pension Framework as per PROST Projection in 2004




Be that as it may, the projections on the 2007 reform framework show that future pensioners will, in the event of no further changes to the pension system, enjoy a lower average pension replacement rate compared to current pensioners who, as shown in **Chart 35**, in 2009 enjoyed an average pension replacement rate of 50%. It is pertinent to underline, that the PWG in its work in 2004 and 2005 had proposed that the difference between the average pension replacement rate enjoyed by pensioners today and the average pension replacement rate's projected behaviour would be compensated by the introduction of a Mandatory Second Pension.

As **Chart 36** shows the average pension replacement rate in 2016 will start to decline until it bottoms out at 42%. Thereafter it will start to increase again until it peaks at 49% in 2040. The above shows that the cohort of pensioners between 2015 and 2035 will be vulnerable to a lower level of adequacy when compared to current pensioners as well as future pensioners.

This is a lower level of adequacy that is unlikely to be compensated by the introduction of a Mandatory Second Pension given that such a Second Pension framework is yet to bet introduced. As will be discussed in the next Chapter, a Second Pension requires time to accumulate the appropriate level of capital that will provide a reasonable rate of return.

In the event that a Mandatory Second Pension is introduced at the earliest possible a 20 year period would have accrued by 2036 from the introduction of such a framework. This would mean that new pensioners from 2037 onwards would benefit from a complementary Mandatory Second Pension income which would boost the average pension replacement rate.

The PWG2010 is of the considered opinion that the minimum average pension replacement rate that the pension system – that is both a First Pension and a Mandatory Second Pension if so necessary – should target should be, at the absolute *minimum no less than* 50% - that is ensuring that future pensioners will enjoy the same level of pension replacement rate in relation to the average wage enjoyed by pensioners in 2009 as currently modelled by the WB.

The PWG2010 presents the following recommendations for discussion and consideration directed to strengthen the sustainability, adequacy and solidarity of the First Pension framework.

### 04.2.1 Increasing the Retirement Age

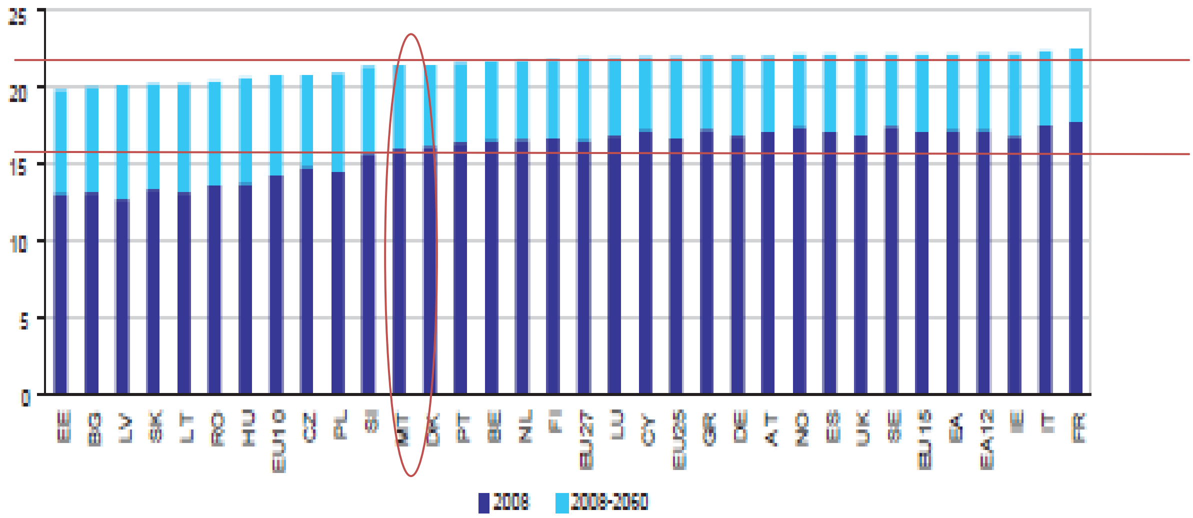
The Chart below depicts Life Tables of the Maltese population at Census years. The life expectancy for males who are 65 years of age between 1948 and 2005 increased from 12.8 to 16.7 whilst that of females increased from 8.2 to 10.3. With regards to males who are 75 years of age, for the same period, the life expectancy increased from 8.2 to 10.3 and that of females from 8.7 to 12.0.

**Table 24: Expectation of Life 1870/72 to 2005**[50]

| Age | Abridged Life Tables at Census Years | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1870-72 | 1890-92 | 1910-12 | 1920-22 | 1930-32 | 1948 | 1957 | 1967 | 1985 | 1995 | 2005 |
| **Males** | | | | | | | | | | | |
| 0 | 44.7 | 41.2 | 43.4 | 45.9 | 41.4 | 55.7 | 65.7 | 67.5 | 70.8 | 74.9 | 77.7 |
| 1 | 55.7 | 50.5 | 54.3 | 57.9 | 56.0 | 64.8 | 68.1 | 68.9 | 71.0 | 74.7 | 77.2 |
| 5 | 54.5 | 59.2 | 58.4 | 58.5 | 58.2 | 61.8 | 64.4 | 65.3 | 67.2 | 70.9 | 73.2 |
| 10 | 53.5 | 54.5 | 54.5 | 54.6 | 53.9 | 57.5 | 59.7 | 60.4 | 62.3 | 65.9 | 68.2 |
| 15 | 49.6 | 50.2 | 50.0 | 50.2 | 49.4 | 52.9 | 54.8 | 55.5 | 57.4 | 61.0 | 63.3 |
| 20 | 46.0 | 46.0 | 45.8 | 46.2 | 45.2 | 48.4 | 50.0 | 50.7 | 52.5 | 56.2 | 58.4 |
| 25 | 42.7 | 42.0 | 41.6 | 42.3 | 41.2 | 44.1 | 45.3 | 45.6 | 47.7 | 51.4 | 53.6 |
| 35 | 34.0 | 33.1 | 33.2 | 33.2 | 32.5 | 35.2 | 33.9 | 36.1 | 37.9 | 41.9 | 44.0 |
| 45 | 26.5 | 24.9 | 25.0 | 25.1 | 24.2 | 26.4 | 26.7 | 26.9 | 28.2 | 32.4 | 34.3 |
| 55 | 19.1 | 17.6 | 17.2 | 17.5 | 16.8 | 19.0 | 18.3 | 18.5 | 19.4 | 23.3 | 25.1 |
| 65 | 12.4 | 10.8 | 10.7 | 11.1 | 10.4 | 12.8 | 11.7 | 11.9 | 12.3 | 15.3 | 16.7 |
| 75 | 7.1 | 6.0 | 6.2 | 6.6 | 5.5 | 8.2 | 6.7 | 6.8 | 7.4 | 9.1 | 10.3 |
| **Females** | | | | | | | | | | | |
| 0 | 47.4 | 42.8 | 44.7 | 45.2 | 43.5 | 57.7 | 68.9 | 71.6 | 76.0 | 79.5 | 81.4 |
| 1 | 55.7 | 50.8 | 54.8 | 57.4 | 57.1 | 56.9 | 70.8 | 72.2 | 75.9 | 79.0 | 80.8 |
| 5 | 54.4 | 59.1 | 58.6 | 58.5 | 59.4 | 63.5 | 67.1 | 68.5 | 71.9 | 75.1 | 77.4 |
| 10 | 53.8 | 54.4 | 54.5 | 54.7 | 54.9 | 58.8 | 62.3 | 63.6 | 67.0 | 70.1 | 72.4 |
| 15 | 50.1 | 50.2 | 50.2 | 50.3 | 50.4 | 54.2 | 57.4 | 58.7 | 62.1 | 65.1 | 67.5 |
| 20 | 46.4 | 46.3 | 46.2 | 46.3 | 46.1 | 49.6 | 52.6 | 53.7 | 57.1 | 60.2 | 62.5 |
| 25 | 42.7 | 42.3 | 41.9 | 42.6 | 41.9 | 45.2 | 47.8 | 48.8 | 52.2 | 55.3 | 57.5 |
| 35 | 34.0 | 33.5 | 33.8 | 33.6 | 33.7 | 36.4 | 38.4 | 39.2 | 42.4 | 45.4 | 47.6 |
| 45 | 26.2 | 25.6 | 25.5 | 25.5 | 25.7 | 27.9 | 29.1 | 29.8 | 32.8 | 35.6 | 37.9 |
| 55 | 18.2 | 18.0 | 17.8 | 17.7 | 17.7 | 19.9 | 20.3 | 20.8 | 23.5 | 26.3 | 28.6 |
| 65 | 12.8 | 11.2 | 11.2 | 11.2 | 10.9 | 13.5 | 13.0 | 13.2 | 15.1 | 17.5 | 19.8 |
| 75 | 7.1 | 6.3 | 6.2 | 6.6 | 5.9 | 8.7 | 7.5 | 7.2 | 8.6 | 10.2 | 12.0 |

Consensus among demographers is that life expectancy will continue to improve. Although there is debate about the pace of improvement and the health trends that affect lifespan, it is considered unlikely that life expectancy will fall. As the pace of longevity improvements to date has been faster than expected, official projections have consistently under-estimated actual average lifespan. Even in the last few years, these projections have been revised upwards. EUROPOP 2008, in fact, estimates that the unisex life expectancy of the Maltese population is expected to increase by a further 10 years by 2060.

**Chart 37: Projections of Life Expectancy at 65 years by 2060**




Source: EUROPOP 2008

It is pertinent to underline that it is not just Malta that faces the consequences of an ageing population. Average life expectancy is rising in all EU member states as well as most developed nations, as can be seen from the Chart above, and many are revising their state pension ages and entitlements in response. Norway, Iceland, Israel and the USA already have a state pension age of

[50] Pg 56, 2009 Demographic Review, National Statistics Office, Malta, 2010

66 or higher. Australia, Denmark, Germany, Ireland and the Netherlands will all have a state pension age of 66 before 2026; whilst Ireland, Australia, Netherlands, Denmark, USA and Germany have already committed to increase the retirement age to 67 years by the end of 2030.

**Table 25: State Pension Age Increases by Country**[51]

| State pension age | 66 | 67 | 68 |
|---|---|---|---|
| Date | | | |
| In 2010 | USA | Iceland<br>Israel (men)<br>Norway | |
| By 2020 | Ireland (2014)<br>Australia (2020)<br>Netherlands (2020)<br>UK (2020) [new plans] | | |
| By 2030 | Germany (2024)<br>Denmark (2025)<br>UK (2026) [legislated] | Ireland (2021)<br>Australia (2024)<br>Netherlands (2025)<br>Denmark (2027)<br>USA (2027)<br>Germany (2029) | Ireland (2028) |
| By 2040 | | UK (2036) | |
| By 2050 | | | UK (2046) |

In the 2007 reforms the Government increased the mandatory retirement age to 65 years of age for persons who were 45 years and younger at the time of the reform; and incrementally increased the retirement ages of persons who were 54 and 46 years of age to 62 years and 64 years respectively. The question that needs to be addressed given that longevity of the Maltese population is expected to improve further is whether the retirement age should be increased even further than 65 years of age in the period between 2026 and 2060.

There are three options of how the retirement age can be increased. The first is to remove the mandatory official retirement age where the employment of a person is automatically terminated and the extension of further employment rests with the employer. The removal of the mandatory official retirement age would mean that the decision to exit employment once a person reaches the official retirement age would now rest with the employee and not the employer. An employee, however, would still have to meet the full contributory period to receive the full First Pension.

The second option is to adopt a stepped approach towards the increasing of the official retirement age – where age increases are directly correlated with dips in the sustainability of the First Pension system. This, as experienced recently in France and Greece, is a controversial approach that could lead to social unrest as such a decision is too often interpreted to be politically motivated.

A third option is that of adopting a formulistic approach where the retirement age is directly correlated to a longevity index. This means that as the longevity of the population increases incremental adjustments are triggered to the official retirement age.

The Swedish pensions system applies such a formulistic approach where the official retirement age of 65 years of age is directly linked to life expectancy adjustments. The Table below shows the effect of the continued increase expected in the average life span of the Swedish population compared with the birth cohort 1930, which reached age 65 at the time the Swedish government took the decision to introduce this longevity indexation mechanism in the pensions system.

The remaining life expectancy for persons born in 1930 at age 65 will increase from 17 years and 5 months to 22 years and 2 months for those born in 1990. This translates to an increase in life expectancy of 4 years and 9 months for the birth cohort 1990 relative to the birth cohort 1930.

Thus, under the Swedish system for those persons born in 1990 to have the same monthly pension level as those persons born in 1930, a proportion of the anticipated increase in the remaining life expectancy at age 65 must be spent further working.

[51] Pg 16, A Sustainable State Pension: When the State Pension Age will Increase to 66, Department for Work and Pensions, United Kingdom, November 2010

For the birth cohort 1990, therefore, the duration of working life under the Life Expectancy and Retirement Age Indexation would increase by 3 years and 3 months if this cohort seeks to achieve the same replacement rate as persons born in 1930 and at the same time the official retirement age will be 1 year and 11 months longer than persons born in 1930.

**Table 26: Swedish Life Expectancy and Retirement Age Mechanism**[52]

| Birth cohort born in | ..reaches 65 in | Life expectancy at 65 | Retirement age required | Time spent retired** | ... compared to birth cohort 1930 |
|---|---|---|---|---|---|
| *1930* | *1995* | *82 yr 5 mo* | *65 yr* | *17 yr 5 mo* | *0* |
| *1940* | *2005* | *83 yr 7 mo* | *65 yr 11 mo* | *17 yr 11 mo* | *+6 mo* |
| 1945 | 2010 | 84 yr 2 mo | 66 yr 3 mo | 18 yr 3 mo | +10 mo |
| 1950 | 2015 | 84 yr 7 mo | 66 yr 6 mo | 18 yr 5 mo | +1 yr |
| 1955 | 2020 | 85 yr 1 mo | 66 yr 10 mo | 18 yr 7 mo | +1 yr 2 mo |
| 1960 | 2025 | 85 yr 6 mo | 67 yr 1 mo | 18 yr 9 mo | +1 yr 4 mo |
| 1965 | 2030 | 85 yr 10 mo | 67 yr 4 mo | 18 yr 11 mo | +1 yr 6 mo |
| 1970 | 2035 | 86 yr 2 mo | 67 yr 7 mo | 19 yr | +1 yr 7 mo |
| 1975 | 2040 | 86 yr 6 mo | 67 yr 10 mo | 19 yr 1 mo | +1 yr 8 mo |
| 1980 | 2045 | 86 yr 9 mo | 68 yr | 19 yr 2 mo | +1 yr 9 mo |
| 1985 | 2050 | 86 yr 11 mo | 68 yr 1 mo | 19 yr 4 mo | +1 yr 11 mo |
| 1990 | 2055 | 87 yr 2 mo | 68 yr 3 mo | 19 yr 4 mo | +1 yr 11 mo |

* The calculations show the retirement age required if the rules of the new system are fully applied. The required retirement age for birth cohorts 1940-1950 is thus overstated.
** Time spent retired is calculated as life expectancy at the required retirement age.

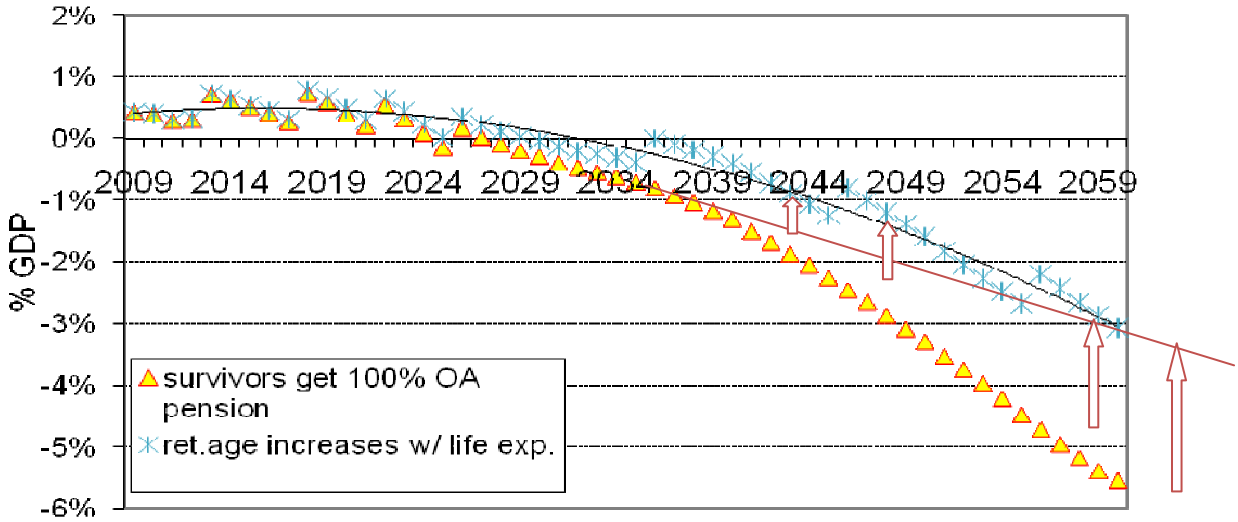
In essence, therefore, the Swedish model achieves two important conditions. First it results in an increase in the official retirement age as the longevity of the population improves. Second it places the obligation on securing a pension replacement rate that is equal to that enjoyed by the 1930 age cohort base on the individual. Thus, whilst a 1990 age cohort must work an additional 1 year and 11 months when compared to the 1930 age cohort to receive the full pension he or she will have to opt to work for a further period of 1 year 4 months should he or she seek a similar replacement rate to the 1930 age cohort.

The attractiveness of the Swedish Life Expectancy and Retirement Age Indexation is that increases in the official retirement age are based on a rational and non controversial formula that can be explained and understood by society at large. Moreover it secures a smooth and automatic process established within parameters that are both transparent and clear. It is pertinent to underline, that by accepting and introducing this longevity indexation the discussion on an increased working life in Sweden is now de-politicised.

A modelling of the impact of a Life Expectancy and Retirement Age Mechanism grafted onto the First Pension is shown in **Chart 38** below. This model assumes that the Maltese longevity index will increase relatively similar to that of Sweden: which would result a response of three one year increases in the retirement age between 2035 and 2060.

[52] Pg 30, Orange Report: 2009 Annual Report of the Swedish Pension System, Pensions Myndigheten

**Chart 38: Impact of a Life Expectancy and Retirement Age Mechanism Grafted onto the First Pension**




Source: World Bank Improving Sustainability of the Current Pension Scheme: Alternative Scenarios, Report, November 2010

The introduction of such a mechanism will have a positive impact on the sustainability of the First Pension. As can be seen from the above Chart the accelerated degeneration of the deficit of the pension system is braked. Whilst the pension system continues to remain in deficit, the deficit, nevertheless, is reduced by approximately 45% - from approximately (5.7%) of GDP to (3%) of GDP.

The PWG2010 recommends that the Government should consider undertaking the appropriate work to design a retirement age - longevity index and to graft such an index onto the First Pension System.

## Recommendation 20

The 2010 Pensions Working Group recommends that the Government should consider linking the official retirement age of the First Pension system to a retirement age - longevity index.

In discussing an increased working life two particular issues require attention. First, even though life expectancy may result in healthy living the fact remains that there will continue to be occupations which cannot be carried out by a person once he or she reaches the age of 61 years.

The PWG2010 in this regard is of the considered opinion that the measures introduced in the 2007 reforms that allows a person to exit the labour market if he or she meets the full contributory period at the age of 61, subject that once the person exited the market he or she cannot return back into the market until age 6, continues to provide the appropriate balance in this regard.

Be that as it may, in the event that a retirement age-longevity index is grafted onto the First Pension system then the disincentive period where-in a person upon exiting the labour force at age 61 is forbidden to carry out employment until age 65 will be extended to reflect the adjusted official retirement age as increased by the said retirement age – longevity index.

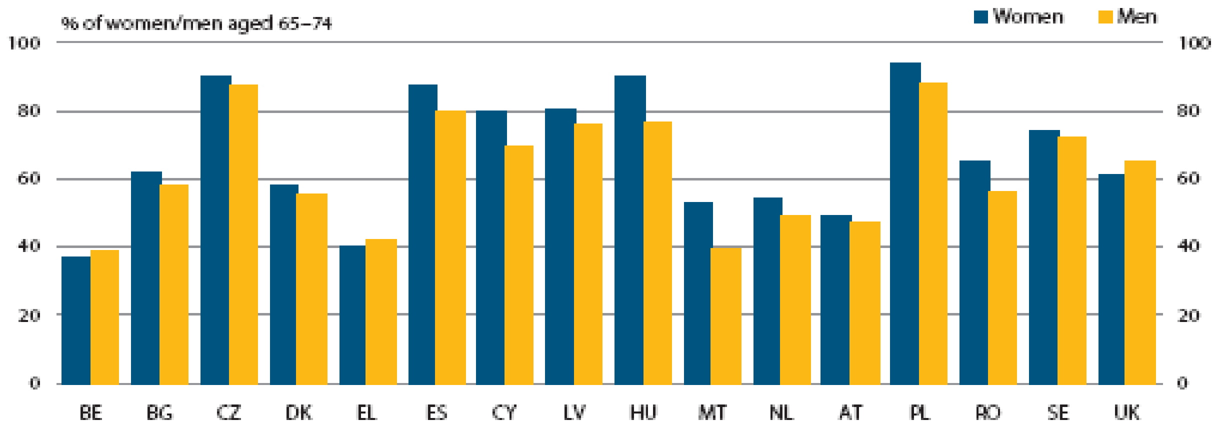
## Recommendation 21

The 2010 Pensions Working Group recommends that the Government should consider indexing the 61 years of age opt out rule to a retirement age – longevity index grafted onto the First Pension system so that the disincentive period increases in equal relativity to increases in the official retirement age.

Second, it is pertinent to underline that living longer does not necessarily mean that a person will have a better quality of life.

It is, for example, scientifically proven that the incidence of certain debilitating conditions or diseases such as Parkinson's, Alzheimer's, Dementia, et al increases as a person becomes older. Thus in designing a retirement age – longevity index attention should be directed to ensure that appropriate safeguards to the First Pension system are in place to protect those who whilst living longer are doing so in a debilitated condition.

**Table 27: 2004 Long Term Sickness and Health Problems by Gender Aged 65 - 74**




Source: Eurostat, Health Interview Surveys, 1999-2003

### 04.2.2 Establishing Full Earnings as the Contribution Payment Base-Line

Under the current First Pension system the contribution paid by the Employer, Employee and the State is on basic wage only. A person's salary package most often, however, consists not only of the basic wage but also of allowances such as shift, transport, et al; bonuses such as production, performance et al; overtime, and fringe benefits.

Under the current First Pension system this additional income to the basic salary is excluded from the calculation of a pension as no contribution is paid on this income. Thus whilst a person may have a good salary package in the event that this salary package is constituted of, for example, 65% basic wage and 35% additional income, upon retirement the First Pension is calculated on 2/3 of the 65% basic wage.

An immediate and pervasive impact upon a pensioner under the existing First Pension system is that the quality of life to be enjoyed as a pensioner when compared to that whilst in employment will be doubly effected – first by the nature of the First Pension system vis-a-vis the adequacy of the average pension replacement rate; and then by the fact that the pension will not reflect the actual income earned during employment but rather only the basic wage element of the salary package earned.

Thus the second parametric change that is given due consideration is that of changing the contributory base from basic wage to full earnings.

The introduction of this measure will impact the employee, employer and Government equally with regards to persons whose basic salary is today, as well as in the future, lower than the Maximum Pension Ceiling. In essence, therefore, this should translate into a higher average pension replacement rate for those persons whose basic wage is below the Maximum Pension Ceiling but whose salary is complemented by addition earnings related income.

Be that as it may, the introduction of such a parametric change means that in the immediate term a person will pay a higher a contribution than that paid today – which will marginally or otherwise impact his or her disposable income.

An employer will also be affected as the contribution base to be paid will now be higher and hence this will affect his or her profit margin, competitiveness, et al.  The Government will be impacted both as an employer as well in terms of the subsequent increase in the State's contribution to be made to Class I and Class II contributions of respectively.

The introduction of this measure, unlike the impact of a Mandatory Second Pension, will not affect persons who earn beyond the Maximum Pension Ceiling and thus will not improve their pension replacement rate.

Moreover, and again unlike the introduction of a Mandatory Second Pension, the introduction of this parametric measure will have a direct impact on Pension GDP deficit and will remain at a high unsustainable level.

The 2010PWG is of the considered opinion that given the current economic conditions it is not possible to advocate the introduction of this parametric reform to the First Pension as well as an introduction of a Mandatory Second Pension.  As will be discussed in depth in the forthcoming Chapter the 2010PWG is of the considered opinion that Government preferred option should be to introduce a Mandatory Second Pension as against this parametric reform.

#### 04.2.3 Survivor's Pension

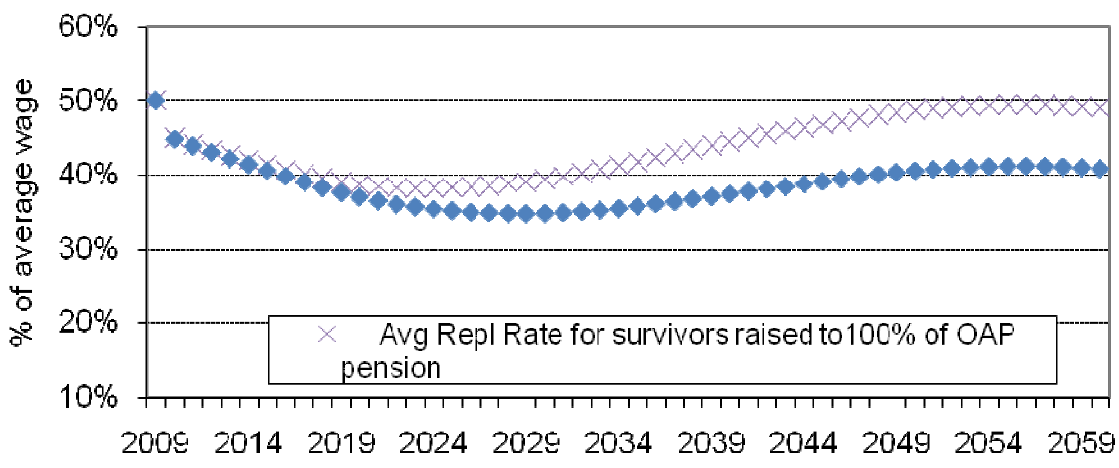
The current social model for a pension system is based on the traditional concept that the male is the breadwinner and that the female is the family carer.  This model does not recognise the economic value of the female in her role as the home carer as well as the ongoing support provided to the husband and her family over a life time journey during which period the husband paid the appropriate pension contributions as required by law.

Thus, should the male spouse of the household pass away, the widow will no longer be eligible for the full pension value but rather to 5/6th of the said pension.

It is the considered opinion of the PWG2010 that the current format of the survivor partnership is gender discriminatory.  Furthermore, it is pertinent to underline that given the fact that a female lives longer than a male she runs a greater probability that she will outlive her mail partner and thus, a female survivor runs a far higher risk to run out of her savings and thereby increase the risk-of-poverty in her regard.

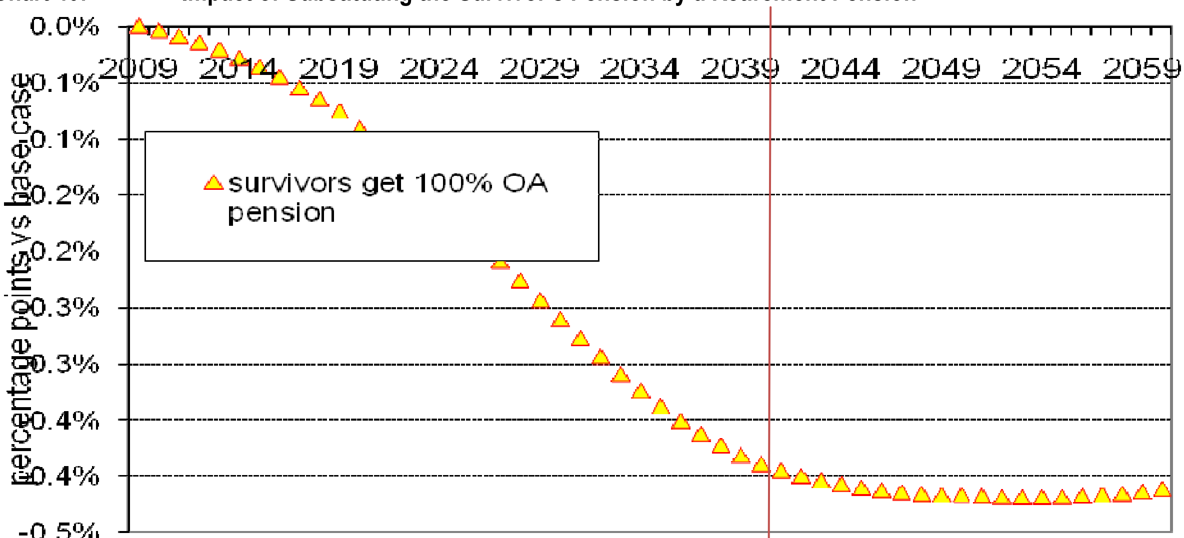
Thus, the PWG2010 is of the considered opinion that a female survivor should be provided the full retirement pension upon the death of her spouse.  The **Chart 39** below shows that the application of such a measure will over time increase the adequacy of a pension to a female survivor by 10%.

**Chart 39: Impact of Full Retirement Pension to a Female Survivor**



The implementation of this measure will have a negative deficit increase of a maximum of (0.45%) which will be reached in 2044.

**Chart 40: Impact of Substituting the Survivor's Pension by a Retirement Pension**




Source: World Bank Improving Sustainability of the Current Pension Scheme: Alternative Scenarios, Report, November 2010

The PWG2010 is of the considered opinion that the Government in 2012 should consider replacing the Survivor's Pension by the eligible full pension to be provided to the surviving female spouse on the grounds that this is gender discriminatory given that the surviving female spouse too would have contributed to the said pension through her role as a home carer during her lifetime.

| **Recommendation 22** |
|---|
| The 2010 Pensions Working Group recommends that the Government in 2012 should consider replacing the Survivor's Pension by the eligible full pension to be provided to the surviving female spouse on the grounds that this is gender discriminatory given that the surviving female spouse too would have contributed to the said pension through her role as a home carer during her lifetime. |

### 04.2.4 Widow's Pension

In the event that a male spouse dies prior to reaching his retirement age the surviving female spouse if she is aged 22 years and over will benefit from a widow's pension subject to the condition that she will forfeit part or all of the pension should she seek employment and that income from employment is greater in value than the yearly average of the National Minimum Wage.

Once again, the PWG2010 is of the considered opinion that this condition is gender discriminatory for the reasons already discussed in 04.2.4 above. Be that as it may, it also acts as a barrier for a surviving female spouse to enter the labour market given that the condition of tying the receipt and value of the pension to income earned from employment up to the national minimum wage acts as a disincentive.

The PWG2010, therefore, recommends that in the case of a widow whose spouse dies prior to retirement age, the widow will not forfeit her right to the survivor's pension even if she continues to work and earn income from gainful activity that exceeds the yearly average of the National Minimum Wage.

**Recommendation 23**

The 2010 Pensions Working Group recommends that the Government in 2011 should consider amending the Social Security Act to allow a widow who is aged 22 years and over when her spouse dies prior to retirement age to work and earn income from gainful activity that exceeds the yearly average of the National Minimum Wage without forfeiting her right to a widow's pension in order to incentivise her to remain active in or re-enter the labour market.

### 04.2.5 Gaps in 40 Year Contributory Accumulation Period of Higher Education Students

The PWG2010 recognises that the parametric reform introduced in 2007 may negatively impact persons who due to continued further tertiary education would not be in a position to accrue the full 40 year contributory period.

The PWG20100maintains the position of PWG that such 'missed' contributions should not be credited by the First Pension system given that:

(i) students in higher education receive stipends that are paid by society and thus they have an obligation to meet towards society; and

(ii) statistics show that persons with tertiary and higher education earn far more than persons without such education.

The PWG2010, nevertheless, is of the considered opinion that the SSA should be amended to allow persons who have gaps of up to 5 years (to cover a period of continued study of a Masters programme (which normally is one year of full time study) and a doctoral programme (which normally is four years of full time study)) in their contributory history as a resulting of following higher education 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.

**Recommendation 24**

The 2010 Pensions Working Group recommends that the Government in 2011 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.

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

The issues discussed in this Report are issues that are being discussed elsewhere in other jurisdictions whose First Pension system is based on a PAYG System. As has been shown in this Report, the Implicit Rate of Return of a PAYG is equal to the growth rate of GDP.
Although, as will be discussed in the next Chapter, the financial market has over the past two years been subject to sustained shocks, a GDP rate of return is typically lower than the rate of return that can be earned in the market – irrespective of whether investment is made in low risk bonds, in equities, or a mixture of both.[53]

A NDC system aims to mimic the structure of funded Defined Contribution systems while maintaining fiscal stability by using such an internally consistent rate of return (with due allowance for the non-steady state context) rather than a market-based rate of return.[54] Pension contributions are tracked in

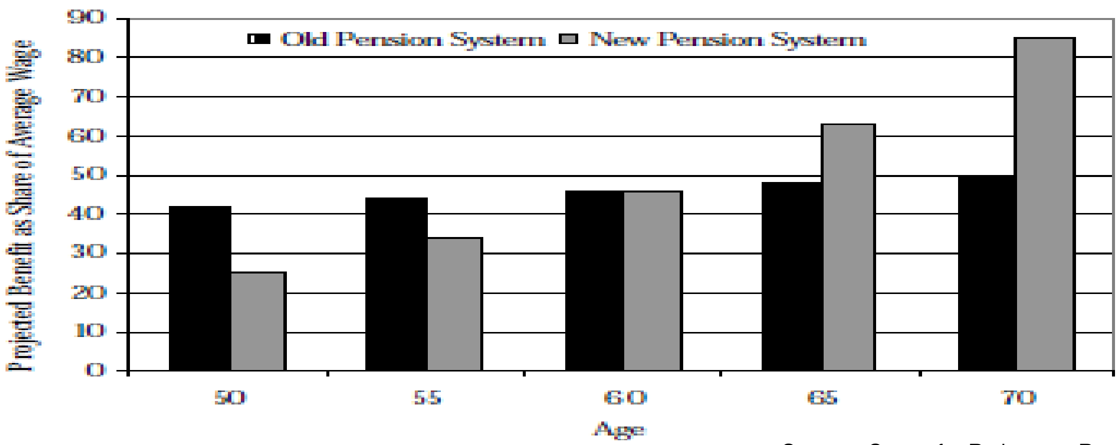
[53] Pg 1, Auerbach, J, A., and Ronald, L., Notional Defined Contribution Systems in a Stochastic Context: Design and Stability, NBER Working Paper, 12805, National Bureau of Economic Research, 2006
[54] Pg 7, Ibid

individual accounts which earn a rate of return. In notional accounts, however, the return that contributions earn is a notional one, set by the government, not the product of investment returns in the markets.

Like traditional social insurance schemes, a NDC system is publicly provided. The pension formula, however, differs somewhat from the 'traditional' earnings related model, with the benefit based on the accumulation in one's account at the time of retirement. Pension accounts in the NDC system are called 'notional' because there is no pot of pension fund money, just a series of individual claims on the future public budget. They are PAYG financed — current contributions pay for current benefits — just like most defined-benefit public schemes. When the individual reaches pension age, accumulated contributions and notional returns — termed notional capital — are converted to an annuity. By adjusting the annuity rate, the government can adjust the pension value to take account of life expectancy.[55]

The NDC scheme is free from the financial crisis caused by the demographic change because of a tight linkage between contributions and benefits.[56] In addition, a major benefit of the NDC scheme is that it establishes a tighter link between workers' contributions and their benefits. This key principle can improve labour force incentives by signalling to workers that the longer they work, the more they will receive in retirement. Thus, under a NDC system, workers would see their account balances continue to grow based on payroll contributions and the account's rate of return. For example, as shown in the Chart below, the new Latvian NDC system has very strong incentives to continue working; replacement rates for an average wage earner are projected to jump from 46 percent at age 60 to 63 percent at age 65.[57]

**Chart 41: Replacement Rates in Latvia Under the Old Defined Benefit Scheme and the New NDC Scheme**




Source: Centre for Retirement Research

In the Swedish NDC pension system part of the former pension system buffer fund was transferred to the NDC scheme to help maintain the contribution rate stable. The new NDC Swedish system applies a lifetime approach to the accumulation of pension entitlements and effectively raises the retirement age as longevity increases. In contributory pension schemes one can set either contributions or benefits, but not both. If the contribution rate is fixed, then no matter how strict the rules that are applied may be, to maintain financial stability pensions must be susceptible to reduction. The means whereby the Swedish reform is expected to guarantee financial stability with a constant contribution rate is through an Automatic Balancing Mechanism. Provided the life expectancies of successive cohorts of retired persons are estimated with sufficient accuracy, at the times they retire the risk of

[55] Notional Accounts: Notional Defined Contribution Plans as a Pension Reform Strategy; World Bank Pension Reform Primer, http://siteresources.worldbank.org/INTPENSIONS/Resources/395443-1121194657824/PRPNoteNotionalAccts.pdf
[56] Pg 12, Min, H., Seo Wook, J., and Jung Ryong, Y., Applicability of the Notional Defined Contribution Model in the US Social Security: Comparison of the NDC Model with the Defined Benefit Model, School of Public Affairs, Arizona State University, October, 2010
[57] Williamson, B, J., Assessing the Notional Defined Contribution Model, Centre for Retirement Research, Boston College, October 2004, Number 24, https://netfiles.uiuc.edu/parente/Econ509/notional.pdf

pensioners' longevity does not affect the stability of the NDC system. The life expectancy applied to a cohort of pensioners is based on the mortality applicable to the cohort at age 65. [58]

Both contributions accumulated in notional individual accounts and pensions are indexed annually according to the increase in average earnings (with 1.6% of expected annual pension indexation taken into account in advance in the calculation of the retirement annuity). Since an important factor in estimating the equilibrium internal rate of return in a mature PAYG scheme is the annual increase in the contributory earnings base, the financial stability of a NDC scheme can be affected by a decrease in the number of contributors – for example increased unemployment levels during a recession. While the buffer fund constituted from reserves of the former pension scheme moderates some deviations, after the long transition period the principal means of maintaining financial stability is the Automatic Balancing Mechanism which defines a ratio of contribution assets to pension liabilities.[59]

Contributors and pensioners both participate in the adjustment which is made if the balancing ratio is less than one, as the indexation of contributions and pensions is reduced until the ratio recovers to one. The effect on contributors' NDC accumulations depends on when in a contributor's career and for how long the reduced indexation is applied. Unlike traditional PAYG schemes where pensions are adjusted by increases in wages or prices (or a combination of both), under the Automatic Balancing Mechanism pensioners are directly affected whenever the balancing ratio is less than one. They lose the amount by which the indexation of their pensions is reduced whenever this ratio is less than one. Given the future expected contraction of the labour force, it is possible that pensioners will suffer decreases in their standard of living compared to the rest of the population. The financial risks due to longevity and a decreasing contributions base are thus borne by NDC scheme participants in their capacities as current and future pensioners.[60]

The PWG2010 whilst it deepened its knowledge of a NDC pension system throughout the course of this Report is not in a position to recommend whether Government should consider such a wholesale transformation of the First Pension system. As shown above, a NDC system has in built features that allow it to self-adjust vis-a-vis financial sustainability and longevity; as well as awarding higher replacement rates for persons who remain active in the labour market.

The PWG2010 is of the considered opinion that the Minister of Pensions should consider appointing a Working Group to assess the possibility of transforming the PAYG First Pension into a NDC First Pension, the short to long term impact of such a reform on the adequacy, sustainability and solidarity of the pension system, the ability to migrate from a PAYG to NDC First Pension and the implementation issues that would have to be addressed. It is proposed that this Report is submitted to Government by 2013 prior to the initiation of the Second Strategic Review which is to take place in 2015.

**Recommendation 25**

A Notional Defined Contribution First Pension system has in built features that allows it to self-adjust vis-a-vis its financial sustainability and longevity; as well as awarding higher replacement rates for persons who remain active in the labour market. The 2010 Pension Working Group is of the considered opinion that the Minister of Pensions should consider appointing a Working Group to assess by 2013 the:

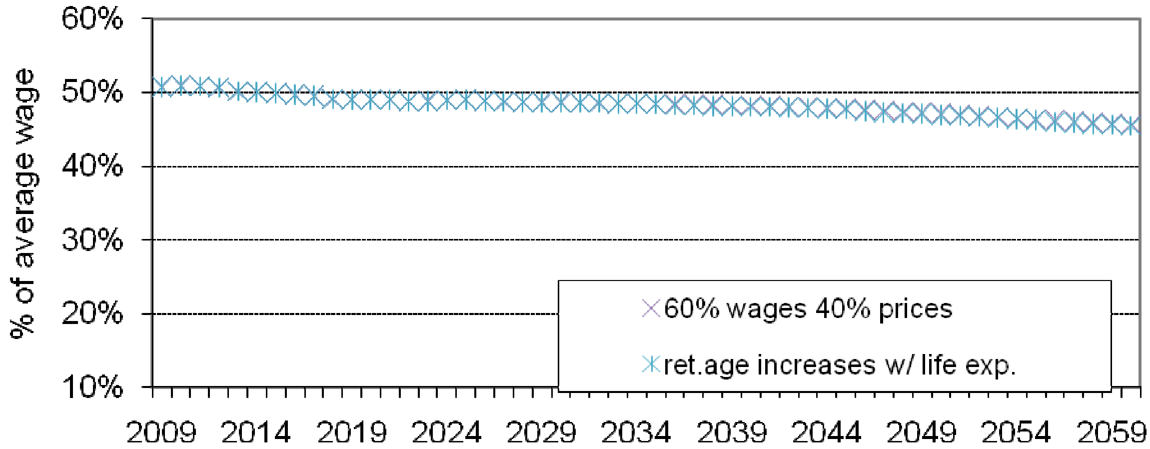
- possibility of transforming the Two-Third Pension into a Notional Defined Contribution First Pension,
- short to long term impact of such a reform on the adequacy, sustainability and solidarity of the pension system,
- ability to migrate from a Two-Thirds Pension to Normal Defined Contribution First Pension; and
- implementation issues that would have to be addressed.

[58] Pg 223, McGillivray, R, W., Reflections on Notional Defined Contributions Public Pension Schemes, NFT 3/2005, http://www.forsakringsforeningen.se/files/2005302.pdf
[59] 224, Ibid
[60] Ibid

As stated in Chapter 4 the minimum pension replacement rate that a First Pension (Retirement) should target to provide an adequate pension is 55%. This replacement rate maintains parity with the average pension replacement rate today.

The proposed parametric changes to the First Pension (Retirement) will result in a replacement rate of 45% as is shown in **Chart 42** below. This means that changes to the First Pension (retirement) alone will not suffice to attain the PROST modelled average pension replacement rate projected for pensioners today – which as discussed earlier should be the absolute minimum average replacement rate for future pensioners.

**Chart 42: Impact of Proposed Changes to First Pension (Retirement)**




As will be discussed in this Chapter and Chapter 06 savings by the Maltese population are decreasing although there is evidence that lead one to assume that savings are being substituted by mortgages as people invest in home ownership. Mortgage investment in home ownership, however, is a 'long term investment' - an investment which does not necessarily translate into accessibility to liquid finance. The PWG2010, therefore, cannot but conclude that Maltese persons will experience a potentially widening gap between the income they enjoyed whilst in employment and the pension they are receiving: a gap that will have a significant negative impact on a person's quality of life in retirement.

There are two primary ways in which the gap in the targeted average pension replacement rate can be bridged in a sustained manner. The first is to increase the National Insurance Contribution rate paid to the First Pension. The second is to introduce a Mandatory Second Pension.

The PWG2010 does not agree that the way forward should be that of increasing the contribution rate paid to the First Pension. An increase of the contribution rate to the First Pension does not remove the demographic risk to the First Pension. Such a measure, therefore, will not remove the intrinsic weakness that plagues the PAYG First Pension.

Furthermore, the First Pension is not a personal saving pension where-in the contribution paid is directed into a personal account of the contributor. The contribution is paid to finance the National Insurance coverage which other than providing for benefits such as unemployment and sick leave also has a strong generational solidarity basis as it provides credits for matters such as Maltese citizens going for voluntary service overseas, ex-members of the Malta Police Force or of the Armed Forces of Malta, etc.

It so follows, therefore, that an increase in the contribution rate paid for the First Pension will not fully translate itself into additional personal savings paid by the contributor. Additionally the risk will always remain that unanticipated future conditions will arise which may impact the adequacy and financial sustainability of the First Pension.

A Mandatory Second Pension, on the other hand, is a pension where-in the savings made will be directly credited to the contributor. A contribution made to a Mandatory Second Pension, therefore, is not a tax – and nor will its value be reduced by a transference of part of its value to finance the solidarity aspect of a First Pension.

A Mandatory Second Pension is a 'forced' saving, where consumption that may be carried out today is deferred to consumption during the retirement phase of a person's life cycle. Moreover, a Mandatory Second Pension is not susceptible to the demographic risk. It is, however, as is discussed in this Chapter susceptible to the risk of market behaviour.

It is pertinent to underline that in the June 2005 report the then PWG stated the following:

> "Indications are that a mandatory Second Pillar Pension Scheme should be in place by 2010. Government should take all the necessary action to establish the appropriate mechanisms to enable the introduction of the Second Pillar Pension Scheme by 2010. Nevertheless, the Government should in 2010 undertake an assessment to determine whether the prevailing conditions at that point in time are such that necessitate the mandatory introduction of the Second Pillar by 2010".[61]

More specifically, the PWG recommended the following:

| Recommendation | |
|---|---|
| No 61 | Implementing the Second Pension Scheme |
| | The neutral introduction of a mandatory Second Pension by means of 'carving' out' 1% Employer and 1% Employee from Class I contribution and 1% Self-employed from Class II contribution with effect from 1st January 2007 [which means that the contribution paid to the First Pension was to become 9% by the State Employer and Employee]. |
| No 63 | Implementing the Second Pension Scheme |
| | The contribution to a mandatory Second Pension was to incrementally increase as follows:<br><br>2011: +1% employers+1% employees+1% self employed<br><br>2020: +1% employers+1% employees+1% self employed<br><br>2025: +1% employers+1% employees+1% self employed<br><br>A 4% Employer and Employee contribution (that is a total of 8%) was seen to be the minimum contributory level for a Second Pension fund to generate a substantial level of capital that would result in an adequate annuity pension payment. |
| No 64 | A Maximum Salary Limit of €35,000 (Lm15,000) was to be established as the ceiling for mandatory contributions to the Second Pension. |

The introduction of the above Mandatory Second Pension as proposed by the Final Report of the PWG would have had the following economic impacts.

[61] Pg 52, Pensions Adequate and Sustainable – Final Report, Pensions Working Group, 30th June 2005

Table 28: **Financial Impact of the Mandatory Second Pension Proposed in 2005**

| Income | 1% carve out from Maximum Ceiling 2010 Neutral | +1% 2011 on Max €35,000 | +1% = 2% Total 2020 on Max €35,000 | +1% = 3% Total 2025 on Max €35,000 |
|---|---|---|---|---|
| € | € | € | € | € |
| 50,000 | | 350 | 700 | 1,050 |
| 35,000 | | 350 | 700 | 1,050 |
| 24,000 | | 240 | 480 | 720 |
| 16,000 | | 160 | 320 | 480 |
| 10,500 | | 105 | 210 | 315 |
| 8,000 | | 80 | 160 | 240 |
| 6,000 | | 60 | 120 | 180 |

In essence, therefore, had the recommendations as proposed by the PWG were to be introduced today, a person, depending on his or her income, would in 2011 have to invest a maximum of €350 annually as savings in a Second Pension – a sum that would also have to be borne by an employer.

## 05.1. Household Savings and Disposable Income

The NSO has recently issued the 2008 Household Budgetary Survey (HBS). Whilst the HBS is not a purpose designed household saving instrument it provides a useful basis for determining the level of household income and savings.

The declared total annual net household income was estimated at €2.9 billion, with an average of €20,695 per household. The largest share of total net household income was attributed to employee cash, near cash or non-cash income with nearly €1.9 billion, followed by interest and dividends with €629 million. Net income from self-employment totaled €292 million, while net income from benefits and allowances came up to nearly €149 million.[62]

Annual net household income showed a strong dependency on the educational level of the reference person. Households where the reference person had a tertiary level of education had a net income of €31,883, compared to €13,331 for households where the reference person had no schooling or had a pre-primary level of education.[63]

Distributions of households by main source of income of the reference person revealed that households where the reference person was gainfully occupied had an average net income of €25,718, nearly twice that of other households where the reference person's main source of income was social benefits (€13,368).[64]

The declared total annual household consumption expenditure for all Maltese households was estimated at €2.8 billion, with an average of €19,575 per household. This was over 10 per cent higher than the figure recorded in 2000.

[62] Pg xiii, Household Budgetary Survey 2008, National Statistics Office, Malta, 2010
[63] Ibid
[64] Ibid

As in 2000, the largest proportion of household consumption expenditure was on food and non-alcoholic beverages, with an average of €4,399 per year, representing 22.4 per cent of the total expenditure. This was followed by transport with an average of €2,703 per year, or 13.8 per cent. The smallest proportions were recorded for education, and for alcoholic beverages and tobacco, with 1.7 and 2.5 per cent respectively.

**Table 29: Income and Consumption by Household Composition Type**[65]

| | Average Net Income | Annual Household Consumption | Difference |
|---|---|---|---|
| Household Composition Type | | | |
| Household 2 Adults and 2 Dependent Children | €22,583 | €24,103 | (€1,520) |
| Household where reference person has no Schooling Primary / Pre-Primary level of education | €13,331 | €10,844 | €2,487 |
| Household where reference person has a Primary level of education | €16,100 | €14,799 | €1,301 |
| Household where reference person has Secondary level of education | €19,838 | €19,485 | €353 |
| Household where reference person has a Post Secondary level of education | €24,080 | €23,992 | €88 |
| Household where reference person has a Tertiary level of education | €31,883 | €27,478 | €4,407 |

As can be seen from the above Table, savings in 2008 – that is the difference between consumption and income – for all of the households compositions was low and a household with two dependent children actually made dis-savings. A household with a post secondary level of education practically made no savings. The highest level of saving was made by the household where the reference person holds a tertiary level of education.

**Table 30: Income and Consumption by Net Income Octiles of Reference Persons**[66]

| Net Income Octiles of Reference Persons | Average Net Income | Annual Household Consumption | Difference |
|---|---|---|---|
| €6,000 to €8,000 | 12,048 | €12,137 | (€89) |
| €8,001 to €10,000 | €14,342 | €14,585 | (€253) |
| €10,001 to €12,000 | €18,431 | €18,566 | (€135) |
| €12,001 to €14,000 | €20,478 | €20,880 | (€402) |
| €14,001 to €16,500 | €23,254 | €23,916 | (€662) |
| €16,501 to €21,000 | €26,668 | 23,748 | €2,920 |
| €21,001+ | €39,132 | 30,022 | €9,110 |

If the household income and consumption pattern is looked from the perspective of the Net Income octiles of a reference person then, as can be seen from **Table 30** above, the only two household cohorts that actually saved in 2008 were those in the €16,501 and above categories respectively.

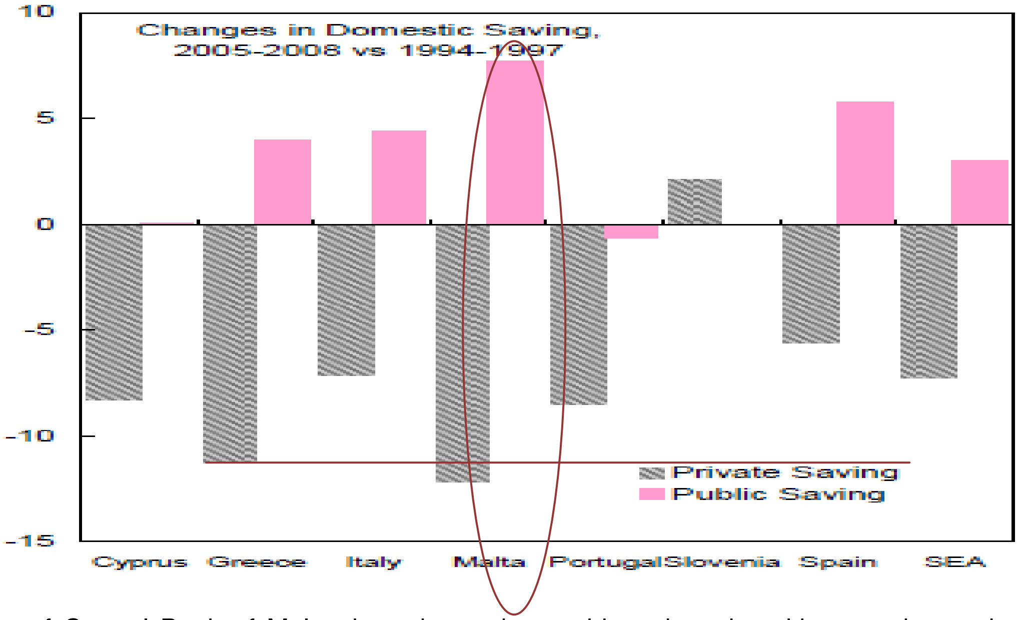
[65] Household Budgetary Survey 2008, National Statistics Office, Malta, 2010
[66] Household Budgetary Survey 2008, National Statistics Office, Malta, 2010

Whilst data relating to income collected through a HBS mechanism needs to be viewed with a degree of caution as respondents normally tend to play down income earned whilst diligently reporting all consumption made, the results of the 2008 HBS are, nevertheless, not encouraging.

The negative trend in private savings can ascertained through other sources. The International Monetary Fund (IMF) in a recent paper shows that the current accounts in the South Euro Area have been deteriorating since 1994 with the downward trend in Malta starting later than for Greece, Italy Portugal and Spain – this coinciding with Malta's entry into the European Monetary Union and the euro area. The paper further adds that the decline in private saving rates was the predominant factor of the decline in Malta's current account.[67]

The Chart below shows that private savings during the period 2005 – 2007 deteriorated by over 10% when compared to the 1994 to 1997 period.

**Chart 43: Private and Public Saving Changes between 2005 – 2008 and 1994 - 1997[68]**




A review of Central Bank of Malta data shows that resident deposits with agreed maturity of up 2 years fell from an increase of 27.1% in 2007 to a contraction of (11.6%) in 2009. This contraction amounted to a drop of €516m in absolute terms; primarily on account of lower holdings belonging to households. [69].

Similarly depositions that are redeemable at notice up to 3 months fell from an increase of 46.8% in 2007 to a contraction of (2.3%) in 2009 – a fall of €2.6m in absolute terms. [70].

During the same period, however, overnight deposits increased from 0.4% in 2007 (were 11.7% in 2007) to 16.5% in 2009[71]. The increase in overnight deposits stemmed primarily from an increase in balances belonging to households and private non financial companies.

The growth in total resident deposits turned negative in 2009, falling from 2.8% at the end of 2008 to (0.3%) in 2009. This drop is seen to be driven by the drop in deposits with an agreed maturity of up to two years – which still accounted for just over half of residents' deposits at the end of 2009.[72]

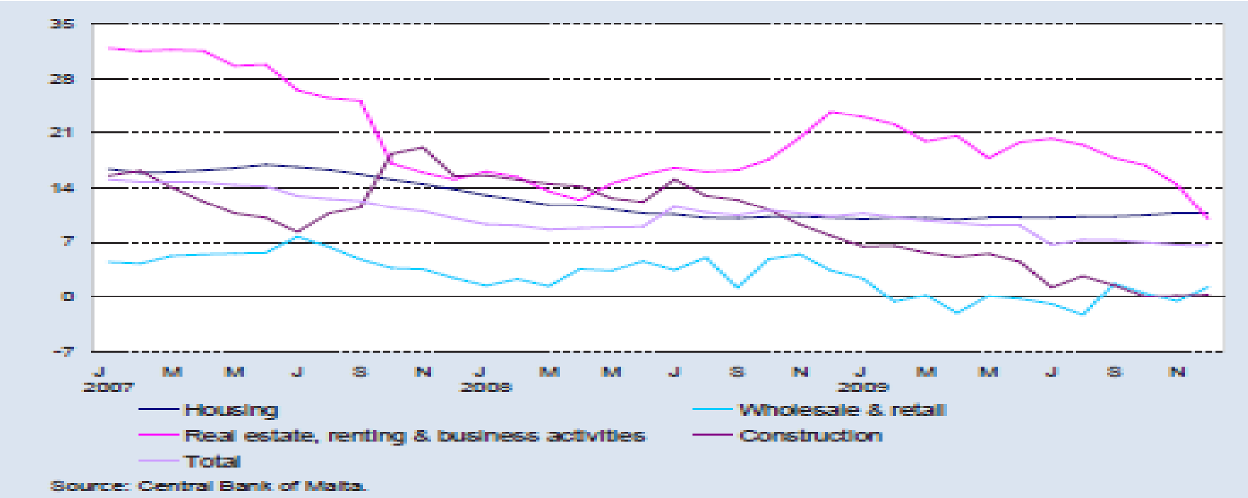
---

[67] Pg 5, Jaumotte, F., and Sodsriwiboon, P., Current Account Imbalances in the Southern Euro Area, International Monetary Fund Working Paper, European Department, WP/10/139, June 2010
[68] Pg 35, Ibid
[69] Pg 30, Annual Report 2009, Central Bank of Malta, 2009
[70] Ibid
[71] Ibid
[72] Pg 31, Ibid

During 2009 credit to residents continued to expand – rising by 9.0% as opposed to 11.8% in 2008. In absolute terms, growth stemmed primarily from a substantial increase in credit to non financial corporations and households. The lower rate of credits when compared to 2008 is a reflection of the slowdown in the domestic economy in the wake of the international recession and arising uncertainty amongst households. Loans accounted for around 97% of total credit with demand stemming predominantly from the non bank private sector. Loans to the latter expanded by 6.8% driven mainly by credit to households for house purchases, which continued to rise strongly.[73]

Mortgages, in fact, continued to register double digit growth rates during 2009 and remained the dominant form of bank borrowing by residents. They accounted for just over half the growth in overall credit to the private sector during the year.[74]

**Chart 44: Annual Private Sector Loan Growth - 2009**[75]




During 2009 the money market continued to be dominated by transactions in short-term bills issued by the Government Treasury. The latter in fact made more extensive use of such instruments to finance its operations. Government issued €1.6 billion worth of bills, up from €1.0 billion in the previous year.

Three-month bills accounted for two-thirds of total issues during the year, with the rest consisting mainly of six-month bills. In 2009 resident banks participated more heavily in Treasury bill auctions than in the previous year, taking up 64% of the amount issued, while insurance companies subscribed to most of the remainder. Almost 2% of the bills issued was taken up by investors resident elsewhere in the euro area.[76]

Net issues of long-term debt securities in the primary market amounted to €492.1 million in 2009, up from €246.8 million in the previous year. On a net basis, government issues were up by €54.0 million to €248.2 million, while securities issued by other residents surged by €191.3 million to €243.9 million. The substantial rise in corporate issues primarily reflected a shift towards market-based financing as bank lending conditions tightened, while the prevailing interest rate conditions offered opportunities to borrow at relatively cheap rates compared to previous years.[77]

Of these, almost 77% were taken up by banks, with insurance companies acquiring most of the remainder. Meanwhile, bonds sold at fixed prices – which constituted approximately 1/3 of the bonds issued - were purchased by retail investors, predominantly households. Overall, non-resident investors took up just under 3% of the government securities issued.[78]

[73] Ibid
[74] Pg 32, Ibid
[75] Pg 33, Ibid
[76] Pg 35, Ibid
[77] Ibid
[78] Pg 36, Ibid

In 2009 the value of debt securities issued by the corporate sector rose even more sharply. Ten bonds were issued during the year, with a combined value of €284.5 million. While 28% of the total was issued by banks, firms in the hotel industry issued an additional 26% the rest were launched by firms in various sectors, including property development. Terms to maturity ranged between three and ten years and coupon rates varied between 5.35% and 7.15%. All issues were over-subscribed.[79]

A consideration that may be reached from the above is that whilst savings in traditional instruments has slightly contracted as well as those households in 2008 where potentially struggling to add to their net savings, investments by households to purchase a house continued to register 'double digit' figures.

In essence this means that to a large degree, a considerable component of the Maltese population substituted savings in deposits with investment in property.

It so follows therefore, that between a person's consumption patterns directed to have a good quality of life and the income that is directed towards the monthly mortgage payment, a household may have limited remaining monthly household finances that can be invested as savings in a financial instrument.

It is pertinent to conclude, therefore, that the danger exists that a significant cohort of the Maltese population will have a high non-monetary investment in a property, and potentially the land upon which it is built, but very little liquid investment to ensure that such persons would be in a position to maintain the quality of life they enjoyed prior to retirement.

The position, therefore, remains unchanged from that identified by the PWG in 2005. In part, concerned by the fact that Maltese were not saving in liquid financial instruments and the resulting negative impact this would have on the life style of persons when they retire – as well as the economy generally given that a greater proportion of a smaller population will be over age 65+ with significant lower access to income than pensioners today – the PWG proposed that Government introduces a Mandatory Second Pension.

In this regard, therefore, one of the primary goals for the introduction of a Mandatory Second Pension is to induce an individual to rise his or her saving capacity over and above that which he or she undertakes on a voluntary basis – or as 'invested' in a mortgage. Thus, a Mandatory Second Pension constitutes the deferral of income, and, consumption from the current stage of the person's life cycle to when a person reaches retirement age.

## 05.2 The Economic and Financial Collapse and its Impact on Private Pensions

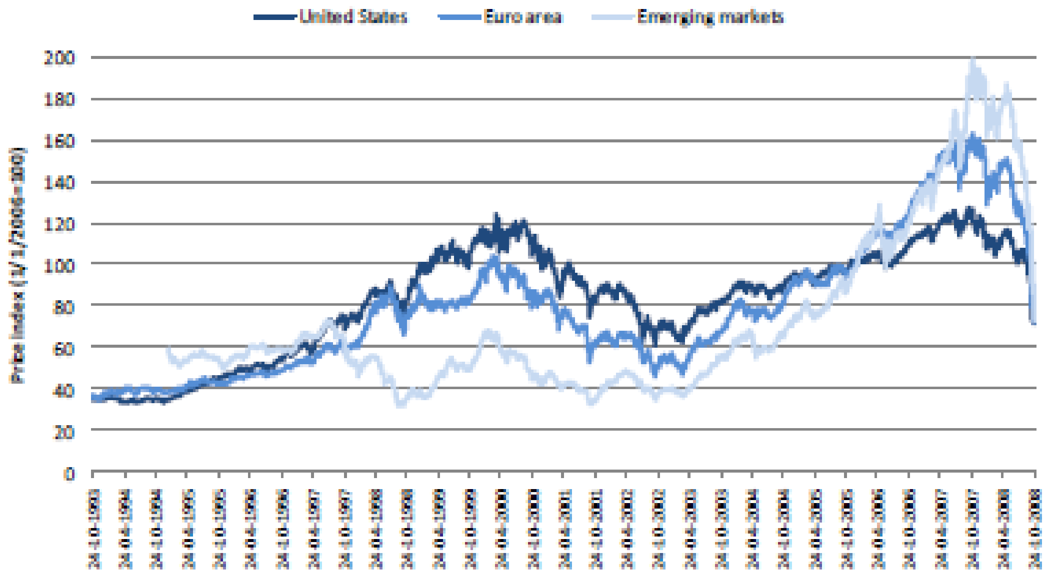
A Mandatory Second Pension is susceptible to the risk of market behaviour. In 2007, prior to the economic and financial collapse, approximately US$28 trillion assets were accumulated in private pension systems – of which 60% (US$17 million) were held by the United States (US) private pension system. In terms of the market value of assets accumulated relative to the size of the economy, Switzerland had the largest private pension system with a ratio of private pension plan assets to GDP of 152%. The OECD weighted average ratio of private pension assets to the area's GDP stood at 111% in 2007.[80]

As shown in **Chart 45** below, the stock market in October 2008 lost approximately 50% of its value when compared to the beginning of 2008.

[79] Ibid

[80] Pg 10, Issue 5, Pension Markets in Focus, OECD, December 2008

**Chart 45: Stock Market Performance: Q3 1993 to Q3 2008**




Source: Thomson Financial Datastream

The crash in the equity market had a major impact on private pension systems – given that private pension funds invested a considerable part of their assets in equity. By October 2008, the total assets of all pension funds of OECD countries experienced a *negative return* of approximately 20% (22% in real terms) - relative to 10 months earlier (December 2007). The principal loss in return is accounted for by pension funds in the US which experienced a loss of US$2.2 trillion out of the total OECD loss of US$3.3 trillion primarily because these pension funds account for more that 50% of the pension fund assets of all OECD countries.[81]

In absolute terms, the second largest loss was the UK – US$0.3 trillion; followed by Australia US$0.2 trillion. Investment losses on all OECD private pension plans – including retirement accounts and pension insurance contracts – are estimated at US$5.5 trillion – of which US$3.3 trillion were in the US alone.

In essence, the dramatic fall in the value of the pension funds in the latter quarter of 2008 meant that persons who reached retirement age during that period and whose pension portfolio is primarily invested in equity lost a considerable part of their individual pension fund which in turn affected the pension annuity they had planned to receive during retirement.

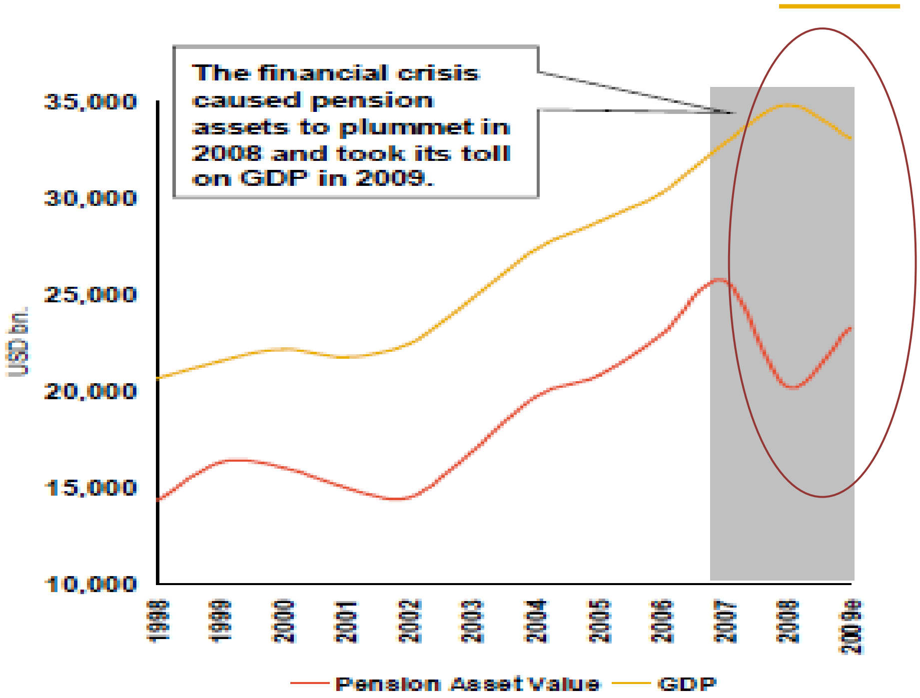
A person who is facing retirement today and whose pension portfolio is primarily invested in equity will continue to be exposed to a lower annuity saving until such time that the pre-crash value of pension funds is restored.

A study by Towers Watson in January 2010 shows, however, that over 2009 the value of global pension assets were up by more than US$ 3 trillion over 2008 – a 15.1% growth in assets when compared to 2008.[82] The average ratio of pension assets to GDP of the countries surveyed by Towers Watson – which include Australia, Germany, USA, UK, the Netherlands, Japan et al – increased from 58% to 70% in 2009 – still down, however to the peak of 78% reached in 2007.[83]

Towers Watson put forward that the recovery is explained by two factors: the rebounding of stock markets and a decline in GDP in all countries surveyed with the exception of South Africa: pension assets increased by 15% and the GDP in the countries surveyed decreased by 5%.

[81] Pg 15, Private Pensions and the 2008 Turmoil in Financial Markets. OECD Private Pensions Outlook 2008, OECD, 2009
[82] Pg 13, 2010 Global Pension Asset Study, Towers Watson, http://www.towerswatson.com/assets/pdf/966/GPAS2010.pdf
[83] Pg 19, Ibid

**Chart 46: Global Pension Assets vs GDP: 2009 Performance**




Source: Towers Watson

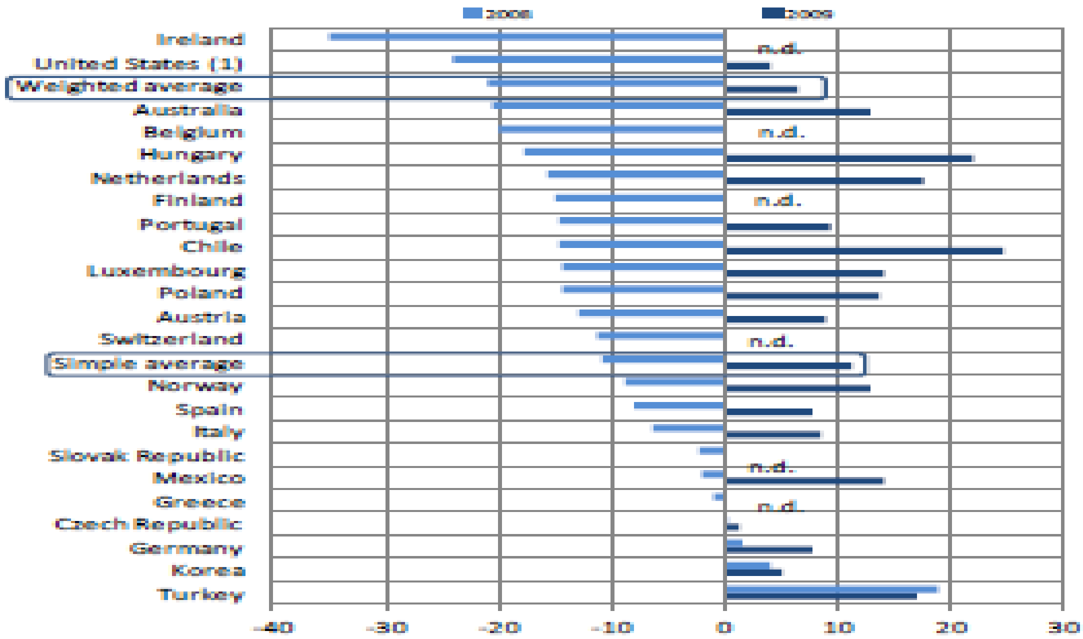
A more recent study carried out by OECD in July 2010 shows that whilst pension funds have strengthened with the financial market rebound, OECD data shows that pension fund assets in most countries have yet to recover to pre-crisis levels. The OECD adds that public pension funds, however, have now fully made up for their crisis related losses due to more conservative investment strategies.[84]

The OECD estimates that as a result of the rebound in equity prices that started in March 2009, the total amount of the pension fund assets in OECD countries recovered around US$1.5 trillion of the US$ trillion in market value they lost in 2008. Despite this recovery, the OECD estimates that the total asset values in the OECD area were still 9% below the 2007 levels on average. Some countries, however, recuperated completely from the 2008 losses – New Zealand, Poland, Austria, Chile, and Norway.[85]

Moreover, pension funds experienced on average a positive investment rate of return of 6.6% in nominal terms up to the end of 2009 – 6.0% in real terms. It is pertinent to underline that in the majority of countries for which 2009 data was available, bills and bonds remained the dominant asset classes, accounting for over 40 percent of total assets in thirteen OECD countries out of twenty one for which such information was available.[86]

[84] Pg 1, Pensions Markets in Focus, OECD, July 2010, Issue 7, http://www.oecd.org/dataoecd/46/46/45637367.pdf
[85] Pg 2, Ibid
[86] Pg 3, Ibid

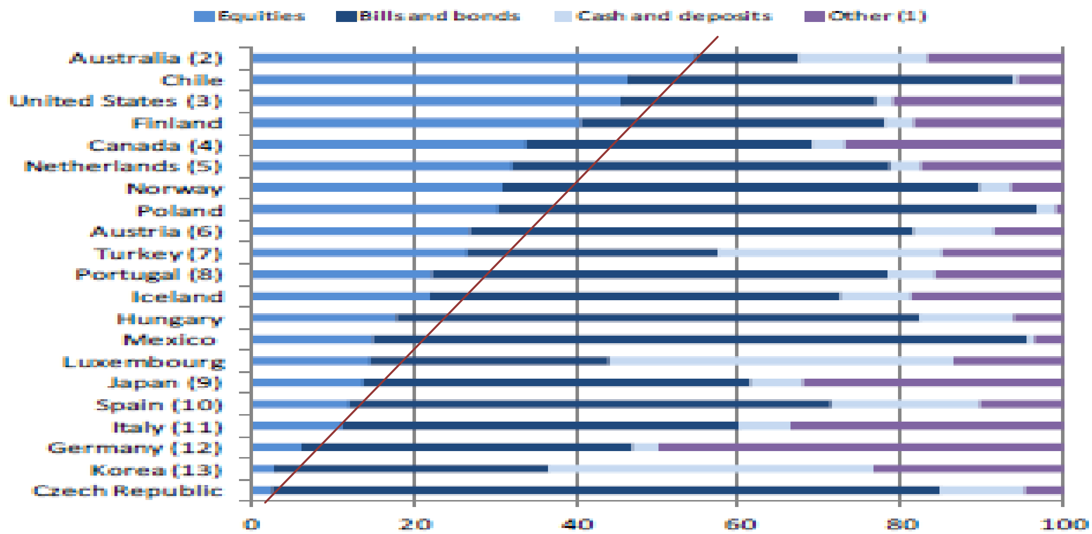
**Chart 47: Pension Funds' Nominal Investment Rate of Return in Selected OECD Countries: 2008 – 2009 (%)**




Source: OECD

Equities ranked first in Australia, Finland, and United States, or are in the same range as bonds in Canada and Chile, with more than one third of all investments. This exposure to equity is a major reason explaining the magnitude of the decline and rise of pension fund assets across these countries. Between 2008 and 2009, the market value of equities in pension fund portfolios in the OECD area increased on average by 1.3 percentage points, from 39.1% in 2008 to 40.4% in 2009. [87]

**Chart 48: Pension Fund Asset Allocation in Selected OECD Countries: 2009 (%)**




In January this year, the OECD launched a pilot project on investments by selected individual pension funds in the OECD area. The purpose of this exercise is to monitor the investment behaviour of large pension funds. For this first survey, information on 6 funds was included from three countries: Denmark, Italy, and the Netherlands.

[87] Pp 5, Ibid

**Chart 49: Total Assets 2009 and Nominal Investment Return in 2008 and 2009 of Select Individual Pension Funds**

| Name of pension fund | Country | Assets under management 2009 (thousands USD) | Assets as a % of country total (1) | Investment return (%) 2008 | Investment return (%) 2009 |
|---|---|---|---|---|---|
| ABP | Netherlands | 287 283 117 | 27.9 | -20.2% | 20.2% |
| PFZW | Netherlands | 99 075 000 | 9.6 | -20.5% | 17.6% |
| PFA Pension | Denmark | 37 802 954 | 12.3 | 2.5% | 6.2% |
| Metaal/tech. Bedrijven | Netherlands | 46 705 556 | 4.5 | -20.7% | 14.8% |
| Cometa | Italy | 6 862 389 | 7.9 | -2.5% | 6.2% |
| Fonchim | Italy | 3 588 417 | 4.1 | -10.2% | 10.9% |

Source: OECD

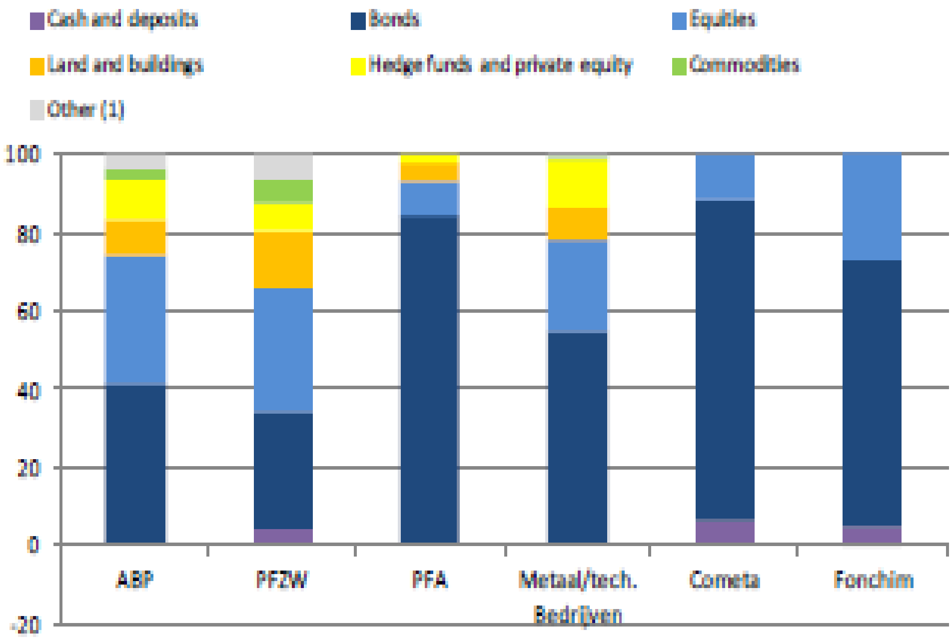
The data shows that the funds with the largest losses in 2008 were the three Dutch funds which were also the funds which experienced the best performance in 2009. The highest cumulative performance over the two years (2008-9) was delivered by the Danish fund PFA Pension, at 4.3% per year on average. In fact, the only other pension fund that has fully made up the investment losses suffered in 2008 was the Italian pension fund Cometa.[88]

These differences in investment performance reflect the wide range of asset allocations observed in the sample of pension funds reviewed. As shown in **Table 31** below, equity exposure at the end of 2009 was highest at ABP, with an allocation of 33.1% while the lowest was PFA's with an allocation of 8.6%. It is also noteworthy that the Dutch funds have the highest allocations to hedge funds and private equity (between 7.4 and 12.3%), real estate (between 8.2 and 9.4%) and commodities (between 0.4% and 6.3%). These three asset classes - often described as "alternative investments" - accounted for 21% to 29% of all assets of the Dutch funds, compared to 7% of the Danish fund PFA and 0% of the Italian funds. [89]

The simplest asset allocations were observed among the two Italian funds which had practically only listed equities and bonds in their portfolios. Exposure to structured products (including asset- and mortgage-backed securities, classified under bonds in Table 20 below) was also relatively low among all the funds surveyed, the highest being PFA's at 3%. The level of international diversification was generally very high, with exposures to foreign equities representing more than 90% of the total stock of equities held by the pension funds.[90]

[88] Pg 10, Ibid
[89] Ibid
[90]

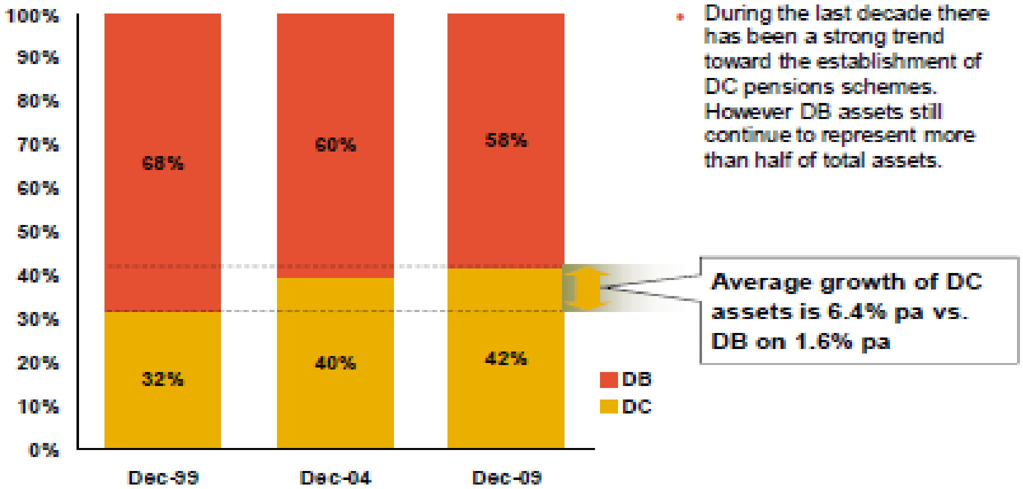
**Table 31: Asset Allocation among Six Funds, December 2009**




Source: OECD

It is pertinent to note that over the past ten years there has been a distinct shift towards Defined Contribution (DC) pension schemes. This shift towards DC schemes is likely to increase as liabilities of Defined Benefits (DB) schemes are forcing major international companies to restructure their pension funds in order to reduce the pension liability and maintain the viability of the operating business.

**Chart 50: Defined Benefit Schemes and Defined Contribution Schemes Assets**




Source: Towers Watson

## 05.3 Reactions to the Post 2008 Economic and Financial Environment

As shown in preceding Section, the private pensions market in 2009 has rebounded following the 2008 collapse even though it has yet to reach the pre 2008 levels.

In a DC pension scheme the value of the pension depends directly on the market value of the assets held in individual accounts. Thus a significant drop of the value of equities in pension funds as discussed earlier in this Chapter will have a direct impact on the value of a pension **at the point** the person retires and starts to draw down his or her private market pension.

In essence, therefore this has a number of significant impacts. Given the fall in the value of pension funds in 2008 persons who retired in 2009, undoubtedly, were negatively affected in terms of the value the pension they will receive over the term of their retirement. Markets perform, however, cyclically.

Thus a person who retired in 2009 will receive a higher pension return than a person who held the same job and salary but retired in 2008 – and that some retiree will, nevertheless, receive a lower pension return than a person who held the same job and retired in 2007.

Moreover, a person who entered the labour market in 2009 or is a relative young worker who has been in the employment market for a number of years will most likely not be negatively impacted by the 2008 crash as the market would have recovered from this particular crash – and potentially gone through a number of cyclical different economic performances.

A person, however, who is elderly and close to retirement and who would have to purchase an annuity at the time of when he or she retires, in say two years time or so, would most likely suffer a permanent income loss particularly if his or her pension portfolio is highly geared towards equities should the pension market fail to rebound to pre 2008 levels prior to his or her retirement.

A DB scheme on the other hand is, in principle, unaffected by changes in an investment's rate of return as an employer would have entered into a pension contract with an employee that at the end of the employee's work life he or she will receive a pension value with a pre-defined financial level irrespective of how the market may be performing at the time.

Thus, if the pension assets are under-performing, and the pension fund's liabilities are higher than the asset value, the financing of the funding gap between DB pension scheme funds and the employers' balance sheet is forcing employers to embark upon recovery plans to reduce the deficit. General Motors DB pension scheme is quoted to be underfunded by US$20 billion.[91]

Solutions tend to range from an employer increasing the level of contributions or in reducing the actual benefits that are supposed to be guaranteed under the DB pension scheme.

Employees in a DB pension scheme could experience benefit loss if they lose their job before they complete the vesting period, or if deferred benefits are not protected against inflation. An employee who is a member of a DB scheme may lose his or her pension or a substantial part of it even if legislation provides protection, in the event that the employer goes bankrupt and the pension scheme is underfunded.

Although the markets have indeed rebounded in 2009, the markets remain nervous given the continued fragility of the global financial markets as well as regional and individual national economies. As can been seen from recent developments in the EU a number of member states with

[91] Pg 5, Mitchell, S, O., Implications of the Financial Crisis for Long Run Retirement Security, Pension Research Council Working Paper, The Wharton School, University of Pennsylvania, PRC WP2010-02, January 2010

high debt-to-GDP ratios are facing difficulties to rising spreads on their sovereign bonds thus posing challenges for both national and European policy-makers[92].

Given the continued uncertainties in the financial markets and the economic sustainability on nations growth may constrict or will be muted at best in the near and short term if the continued fragility causes investors to become significantly more risk averse or if there is a major crisis of confidence prompted by a default or major restructuring of high income sovereign European debt as experienced earlier in November this year. A default or major restructuring among the EU-5 (Greece, Ireland, Italy, Portugal and Spain) could threaten the solvency of several banks outside the EU-5, with potentially far-reaching consequences for the global financial system. Banks located in Austria, Belgium, France, Germany, and the Netherlands have loan exposures to heavily-indebted European countries totalling €1.4 trillion at end-2009, with those exposures exceeding the capital of these banks in many countries. A sharp decline in the value of such assets may threaten the solvency of some of these banks, with potentially far-reaching consequences for the overall banking system and the global economy.[93]

It is pertinent to underline that the nervousness on the fragility of the recovery has seen stock markets, and therefore equities as well as bonds, being negatively affected in 2010. Stock markets worldwide lost between 8 and 17 percent in May, with losses generally larger in high-income Europe and developing Europe than in markets further removed from Greece. Moreover, data for May 2010 indicate a significant decline in capital inflows toward developing countries, although year-to-date flows are 90 percent higher than in 2009. Most of the decline was concentrated in bond issuance by developing countries, with more modest declines in bank-lending and equity flows. Although it is difficult to determine with precision to what extent this reflects a normal seasonal decline in flows, or a temporary reduction in issuance prompted by elevated spreads at the beginning of the month, these developments could signal a further tightening of capital markets.[94]

In addition, a major consequence of the financial crisis in Europe is that fiscal austerity measures are now forced back on the national policy agenda of many countries. Portugal, Spain, Italy, the United Kingdom, Ireland, Greece to mention some EU members states which have persistently been in the news have embarked upon budget strategies directed to reduce, in some states like the United Kingdom very aggressively whilst in other more slowly and cautiously, public spending and debts. Although inflation is currently not seen as a threat, tighter monetary policy is nonetheless on the menu.

The economic impacts of a Mandatory Second Pension on Maltese employers and households within an economic and financial environment that, whilst having rebounded from 2008 levels, is still fraught with uncertainty and nervousness as shown in this Chapter raises question on the timing of when a Mandatory Second Pension is to be introduced.

## 05.4 The Timing of Implementation and the Design of a Mandatory Second Pension Framework

### 05.4.1 The Timing of Implementation of a Mandatory Second Pension Framework

This Report maintains that a Mandatory Second Pension continues to be an important policy objective in securing sustainability and adequacy in Malta's pensions system in spite of the financial and economic uncertainties.

The rationale supporting a well balanced First and Mandatory Second Pension framework is that of diverting risk – where:

[92] Pg 2, Global Economic Prospects: Fiscal Headwinds and Recovery, The International Bank for Reconstruction and Development / The World Bank, Volume 1, Summer 2010, http://siteresources.worldbank.org/INTGEP2010/Resources/FullReport-GEPSummer2010.pdf
[93] Ibid
[94] Pg 17, Ibid

- the public aspect of the pension system is primarily dependent on the demographic risk and the resulting demographic replacement rate – that is, how many persons will be in employment to support every pensioner.

- the private aspect of the pension system is dependent on the market exposure of the pension instrument on the one hand, but separated from under-funding of public pensions or in the case of Malta, where no such public pension fund exists, on the solvency of the Consolidated Fund.

Thus, the PWG2010 is of the considered opinion that the financial and economic crisis, ***of itself***, does not diminish the importance of private pension provision in a well balanced private and State pension framework directed to ensure a quality of life during retirement.

In this regard it is believed pertinent to refer to the private pension policy response to the economic and financial crisis issued by the OECD[95] in June 2009. The policy response of the OECD states:

> "Assessing policy responses to the financial and economic crisis in light of OECD and IOPS guidelines and best practices, has helped in drawing some lessons on the important role of private pensions in complementing public systems, and on how pension arrangements should be best designed to introduce some degree of protection, improve sustainability of funding, enhance management and supervision, and set up disclosure and communication. The main messages of this assessment are as follows:
>
> Stay the course. Complementary private provision for retirement remains a necessity. Whilst some governments are being pressurised to retreat from private pension, public PAYG systems face sustainability problems given aging populations and also affected by the crisis as unemployment increases.
>
> Private pensions still have a major role to play to maintain balanced sources of retirement income. …".

The key questions that the PWG2010 has grappled with during the course of its work is not whether a Mandatory Second Pension is necessary but rather when should a Mandatory Second Pension be introduced and what is the best design framework for a Mandatory Second in order to:

- protect to the best level possible the savings invested for retirement by a person in a Mandatory Second Pension given the experiences of the past two years both with regards to an inability of the supervisory competent authority to safeguard good practice of the person prudent principle and the impact of deep recessions on pension portfolios that are primarily equity structured; and

- Ensure that the person saving for his or her retirement in a Mandatory Second Pension obtains the highest rate of return possible by reducing the costs of administration of the pension fund to the absolute minimum.

The PWG2010 is recognisant of the fact that a recommendation to delay the introduction of a Mandatory Second Pension will have a negative impact particularly on those cohorts of persons who were 30 to 40 years of age on the date of when the Final Report of the PWG was presented to Government.

A person, who was 40 years of age in 2005, will be 45 years of age today. The gravity of the pensions system situation and the mitigation measures proposed to Government at the time contemplated a First Pension Parametric reform – implemented – *together with* the introduction of a Mandatory Second Pension by 2010 subject to pertaining conditions.

A decision not to implement a Mandatory Second Pension, therefore, means that the level of risk that a person who is 45 years of age in 2010 with regards to the sustainability and adequacy of his or her pension will increase. As matters currently stand the level of risk that such a person faces is further accentuated by the fact that a person has had over the past 5 years and continues to have no recourse to a voluntary Third Pension.

[95] Pg 7, Private Pensions and Policy Responses to the Crisis – Recommendation on Core Principles of Occupational Pension Regulation, OECD, June 2009

Be that as it may, even in the event that a voluntary Third Pension option is available the risk coverage provided by such an instrument will incrementally decrease the longer the investment period that is open to a person who seeks to invest in a Third Pension. The decision by the then PWG to establish 45 years and younger as the entry point into a Mandatory Second Pension – rather than, say, 50 years and younger - arises from the fact that for a private pension fund to accrue a reasonable level of capital as well as to neutralise the affects of economic cycles on the value of a pension fund a minimum twenty year contribution and accumulation period is required.

The above discussion, therefore, leads to the question of when should a Mandatory Second Pension is introduced? In truth, is there a right time of when such a pension is to be introduced?

There is no simple answer to this question. In seeking to reach an answer one must weigh, on the one hand, the certainty that the First Pension will not provide an appropriate average pension replacement rate that will allow a future pensioner to bridge the disparity between a quality of life enjoyed during employment and that which will be enjoyed during retirement with, on the other hand, the:

(i) uncertainties of securing global economic sustainability concerns and the behaviour of the financial market; and

(ii) impact of a Mandatory Second Pension on the national economy.

The former has already been discussed. With regards to the latter the introduction of a Mandatory Second Pension is seen to have the following impacts on the local economy:

01. Increase aggregate savings as well as individual savings; ensuring therefore a smoother transition from a quality of life enjoyed during a person's employment to a lower retirement pension income that is subject to the First Pension replacement rate.

02. Negatively impact disposable income with particular regard to low income and lower middle income groups.

03. May potentially result in increased debt by an individual – particularly those in lower income groups – in order to compensate for a lower level of disposable income due to the payment of the Mandatory Second Pension contribution.

04. May potentially have a neutral or minimal impact on individuals in high or middle income groups who already save in endowment or unit-linked policies in the event that they would opt to lock the surrender value or maturity value of such schemes in a Mandatory Second Pension – although this would mean that a lower level of aggregate savings would be achieved if this measure had to be implemented.

05. Negatively impact government finances as contributions paid by the State as an employer will be ring-fenced in a Mandatory Second Pension; with the payment of the additional contribution to be hived off from government revenue or raised through taxation, debt or a reduction in its productive investment programme.

06. Reduce revenue from VAT as a consumption today is deferred to one's retirement life cycle phase.

07. May result in the passing on of the cost of the Mandatory Second Pension contribution by the employer to the consumer.

08. Result in the demand by employees for increase in salaries and Cost of Living Adjustments to compensate in part or in full for the negative impact on net earnings due to a Mandatory Second Pension contribution.

09. Result, in the short term, in the contraction of the demand for labour as employers rationalise employment costs to absorb their part of the contribution to the Mandatory Second Pension;

and a potential reduction in the labour demand over the medium and long term as employers structurally adjust to the Mandatory Second Pension.

10. Result in a loss of competitiveness.

11. May result in an increase in black economy employment as both employers and employees may seek to by-pass the ‘new cost’ – the contribution to the Mandatory Second Pension; and in doing so undermining the raison d’être for a Mandatory Second Pension in the first place.

12. May discourage persons who are outside of the employment market to re-enter the labour market because the return for doing so would not render it worthwhile in the present and immediate term.

13. Given that citizens’ confidence in the private market is negatively affected by the turmoil in international financial markets, an imposition to force consumers to mandatorily save in a private pension framework may result in a backlash of public opinion and public reaction against such a policy decision.

The decision to introduce or further defer the introduction of a Mandatory Second Pension is, therefore, one that is not reached lightly. A decision to defer will impact the quality of life of future pensioners. A decision to introduce will have an impact on the quality of life on today’s employees as well as employers.

Following considerable debate and discussion the PWG2010 recommends that the Government should consider introducing a Mandatory Second Pension directed towards persons who are 45 years of age and younger at the earliest opportunity.

The PWG2010 is of the considered opinion that a decision to defer the introduction of a Mandatory Second Pension will only result in the introduction of a harsher contributory regime – either within the proposed Mandatory Second Pension or in the National Insurance Contribution rate - in the near future as measures would still have to be designed to secure a total average pension replacement rate that is as a minimum equal to that enjoyed by pensioners today.

A deferment, therefore cannot be a solution for it neither lessons nor mitigates in any form the degree of the issues faced nor results in future measures that will be less onerous than if they are introduced in the near term. The only certainty is that the longer the delay the harder will be the impact on employers, employees and future pensioners once a government will act – as it will have to.

**Recommendation 26**

The 2010 Pensions Working Group recommends that the Government should consider introducing a Mandatory Second Pension directed at persons who are aged 45 years and younger at the time when it is introduced.

Given the national significant import of such a decision, the PWG2010 strongly argues that appropriate care and attention should be given to the determinants of how a Mandatory Second Pension is introduced; that is the level of the savings rate to be set, how this is to be phased over time in order to minimise arising shocks to both employees and employers, et al.

The PWG2010 strongly emphasises that a pension reform is not exclusively a financial and technical discussion or exercise with mathematical projections. If these processes, indispensable as they might be, are devoid of the necessary political and social consensus to back them up, any proposal to move ahead in this important area is deemed to fail.

From the research the PWG2010 has undertaken, it transpires that successful pension reforms implemented in countries have been endowed with and preceded by a political consensus which endorses the vision the pension reform is aiming at. The decision to embark on a Mandatory Second

Pension, without any doubt, poses challenges both to the social partners, the political institutions and the population at large.

Thus, it is the PWG2010's strong view that Government should embark on an active discussion process with political forces and with its social partners to discuss and define important modalities surrounding the introduction, setting up and implementation of a Mandatory Second Pension.

To illustrate, these consultations can focus on extremely sensitive but critical aspects of the framework for a Mandatory Second Pension, notably the size of contributions; the sources of financing for these contributions and the phasing in of the framework. These are decisions which are extremely sensitive and which are best reached on the back of extensive consultations.

**Recommendation 27**

The 2010 Pensions Working Group recommends that the Government should consider inviting the Opposition and relevant representatives of both employers and employees to participate in the design and implementation of a Mandatory Second Pension. Strategic and important decisions have to be taken with regards to matters such as the size of contributions; the sources of financing for these contributions and the phasing in of the framework, et al. To the extent possible the introduction of a Mandatory Second Pension should be based on a national consensus.

The introduction of a Mandatory Second Pension will not happen overnight. It requires considerable preparatory work both in terms of its design; governance as well in preparing the appropriate supporting infrastructure. In order to minimise the potential shocks to both employees and employers the PWG2010 recommends that this time is maximised by Government and the representatives of both employees and employers so that both employees and employers are prepared as best as possible for the introduction of a Mandatory Second Pension.

**Recommendation 28**

The introduction of a Mandatory Second Pension will not happen overnight and the 2010 Pensions Working Group recommends that this time is maximised by Government and the representatives of employees and employers so that both employees and employers are prepared as best as possible for the introduction of a Mandatory Second Pension.

### 05.4.2 The Design of a Mandatory Second Pension Framework

#### 05.4.2.1 Regulating and Managing the Investment in a Mandatory Second Pension Fund

The framework of a Mandatory Second Pension can be designed in a number of ways. The Supplementary Paper titled 'Malta Issues and Options for Mandatory and Voluntary Funded Pension Arrangements' prepared by the WB at the request of the PWG2010 provides a detailed overview in this regard.

Following discussion with the WB and a review of the options provided for consideration in its Report the PWG2010 looked at two specific framework models.

*01. Occupational Retirement Pension Framework*

A mandatory occupational retirement pension (OPR) framework basically demands that an employer establishes a pension fund to which employees will become members of. An OPR fund introduced by one employer may be different from that of another employer in so far that the basic criteria of the Second Mandatory Pension are in place and the minimum requirements of the governing legislation are met.

OPRs can be contributory or non contributory, funded or unfunded, DB or DC. An employer or employee can choose any form or variant of a pension scheme provided by pension funds service providers authorised by the governing legislation.

An ORP framework is governed by Directive 2003 / 41 / EC of the European Parliament on the activities and supervision of institutions for occupation retirement provision. The Special Funds (Regulation) Act and the new Pension's Act which is being drafted by MFSA are based on this Directive.

*02. Mandatory Second Pension Framework Established Under the Social Security Act*

A Government may opt for a different pensions investment management framework from that established by the afore mentioned Directive by designing a series of ad hoc funds on market sectors governed by investment principles and guidelines designed specifically for the management of funds within a Mandatory Second Pensions framework. The Government could then issue a public tender for the identification of private sector pension providers to manage the funds.

The supervisory board under such a model would be either an Authority within the Ministry responsible for pensions or the Department for Social Security work.

This is the model adopted by Sweden, where individual pension accounts have been grafted as an additional tier to the NDC First Pension. In the Swedish system 86 fund managers from the private sector were licensed and a total of 785 investment funds (including equity funds, balanced funds, fixed income funds, and life cycle funds) have been established by the end of 2007. The Pension Authority is responsible for:

- contracting with private pension fund providers applying to participate.
- executive aggregate purchases vis-a-vis participating funds.
- collecting and making available information on the share values of a pension fund on a daily basis.
- maintaining and managing the individual pension accounts.
- issuing the year end statements to account holders summarising the individual financial stratus of both the NDC and the Individual Pension Accounts.

A unique feature of the of the Mandatory Individual Accounts pension system in Sweden is the Introduction of a Default Fund. The Default Fund option which is called the AP7 fund, manages the savings for those workers who do not choose a fund – either because they do not feel competent in making such an important financial management decision or are afraid to make such a decision.

The Default Fund's investment strategy is to achieve a higher long-run rate of return than the average for the other private sector funds offered through the Authority at an overall risk level that is the lowest possible compatible with the average rate of return.

It is pertinent to underline that neither in the case of a 'pure' private pension framework nor in a private pension scheme where funds are managed by the private sector and the framework is constituted and governed under a social security framework the rate of return of a mandatory second pension guaranteed. Under either model the contributor, however, is safeguarded against malfeasance and bankruptcy.

It is to be noted that during the course of the consultation process, a number of stakeholders stated that they will only support a Mandatory Second Pension if this is either managed by Government or if the rate of return is guaranteed.

The PWG2010 is of the considered opinion that it would not be possible to design and introduce a Mandatory Second Pension framework where the rate of return of the fund in which a person has invested his or her savings are guaranteed by the State.

The question, however, of how are retirement funds where persons are mandated to save best safeguard remains and is in the opinion of the PWG2010, central to the design of the framework of a Mandatory Second Pension. The PWG2010 have two major concerns with a pure ORP Mandatory framework. The first is that the investment rules established by the afore mentioned Directive are established on the 'prudent person' rules where:

> "(a) the assets shall be invested in the best interests of members and beneficiaries. In the case of a potential conflict of interest, the institution, or the entity which manages its portfolio, shall ensure that the investment is made in the sole interest of members and beneficiaries;
>
> (b) shall be invested in the best interests of members and beneficiaries. In the case of a potential conflict of interest, the institution, or the entity which manages its portfolio, shall ensure that the investment is made in the sole interest of members and beneficiaries; ...".[96]

The prudent person principle is, however, tempered by a limited number of quantitative and qualitative rules which establish that investment should be predominantly in regulated markets; in derivative instruments only in so that they contribute to the reduction of investment risks, etc.

The investment principles in the Special Funds (Regulation) Act as well as in the new Pensions Act that is drafted by the MFSA are based within the parameters established by the Directive.

It is the considered opinion of the PWG2010 that the financial and economic crisis underway in 2008 has exposed the fragility of the prudent person principle as the underlying premise of a regulatory regime for the financial services sector as the crisis itself was the result of the blatant disregard by financial service providers of this principle and the inability of the supervisory authorities to monitor, detect and rectify *ex ante* abuses and mis-management in the management of investment portfolios.

It is further the considered opinion of the PWG2010 that whilst the qualitative and quantitative investment criteria established in the Directive suffice with regards to a voluntary ORP scheme or a Third Pension where the employer or the individual makes a conscious decision to voluntarily set up an OPR scheme or invest in a Third Pension instrument they do not suffice in providing the necessary level of protection for a Mandatory Second Pension framework where an individual is *forced* to save in such a scheme.

**Recommendation 29**

The 2010 Pensions Working Group is of the considered opinion that whilst the person prudent principle and the qualitative and quantitative investment criteria established in the IOPS Directive suffice with regards to a voluntary ORP scheme or a Third Pension where a conscious decision to voluntarily invest in such an instrument is made, they do not suffice in providing the necessary level of protection for a Mandatory Second Pension framework where an individual is *forced* to save in such a scheme.

The second concern with a pure ORP scheme is that it assumes that people are sufficiently educated in financial management to reach the right decision in designing the risk-return profile of their fund portfolio. Second pension plan providers offer a great variety of investment choices to members, from so called conservative to more aggressive investment strategies.

The variety of pension plans confronts individuals with the challenge to choose investment strategies that most suits his or her situation and risk preferences. A rational decision, therefore, requires a thorough understanding of investments and of individual needs and expectations. Empirical research

[96] L235/10, Directive 2003/41/EC of the European Parliament and of the Council on the Activities and Supervision of Institutions for Occupational Retirement Provision, Official Journal of the European Union, 23 September 2003

as will be discussed later in this Report show that many people are incapable or unwilling to make such decisions and those that do are often beset by serious behavioural handicaps.

Studies on the 401(k) pension plans in the US have shown that left to their own actions, even with good education, participants do not always act in their own best interests.[97] Fear and Pace quoted in 'Pension Reform: How Canada Can Lead the World'[98] find that Australia's 2005 Choice of Fund legislation is not leading to better outcomes for retirement savers; rather, Australians "are choosing not to choose."

Moreover, too often, when people establish an investment pension portfolio they are not sufficiently vigilant in monitoring the performance of their fund and to make decisions to protect their portfolio in times of crisis or to be more adventurous when appropriate market conditions to improve the portfolio arise.

Thus a person who designs an equity based portfolio when he or she originally entered the pension scheme and left the investment profile of his or her fund unchanged up to the date of his or her retirement, the value of that person's pension fund is likely to be heavily exposed should that person retire at a time of a financial crisis. A person, on the other hand, who manages his or her portfolio over time in a manner that the fund edges towards conservative instruments (bonds for example) to a full conservative investment profile on the eve of the person's retirement is less likely to be exposed should the person retire at a time of a financial crisis.

An pure ORP framework does not provide a default mechanism that protects a person saving in a pension fund against behaviour inertia. It assumes that a person is active in the management of the fund or has sufficient knowledge of the financial market to instruct the fund manager on how his or her pension fund is to be managed. Most people meet neither assumption.

A Default Fund can be constituted of different life cycle strategies. These include[99]:

- Linear decrease approach where the allocation to equities decreases according to a linear function of age.

- Step-wise linear approach where the equity allocation decreases according to a step function.

- Piece-wise linear approach where the equity allocation decreases according to a piece-wise function.

- Dynamic multi-shaped approach where this strategy is designed to optimise an individual person's asset allocation over the entire lifetime to best match the requirements during retirement. The optimisation criterion which is minimised is the expected shortfall in each year of the retirement period. The event of a shortfall occurs when the pension plan of the person would not be able to satisfy a pre-defined level of consumption.

- Average multi-shaped approach where this strategy is driven by a target date strategy approach from age 25 to age 65. Thereafter its dynamics is driven by a target risk approach.

A linear life cycle Default Fund model, for example, is based on the probability that returns from stocks will outperform (underperform) those from bonds and cash increases (decreases) with the length of the investment horizon. Thus long horizon investors may prefer to have a higher allocation to stocks in their portfolio compared to investors with shorter investment horizons. It is also argues that younger investors in retirement plans should heavily invest in stocks because they have enough time to recover from a stock market downturn should that happen and have a longer working horizon to make up for financial losses. On the other hand, for older investors with a few years to retirement, holding such an aggressive portfolio can, as shown earlier, spell disaster. A major slump in the stock

[97] Pg 10, Kessler, K, E., Constructing New Retirement Systems: Choosing between Insurance and Investment, Choice and Default, Pension Research Council, The Wharton School, University of Pennsylvania, PRC WP2009-10, August 2009

[98] Pg 9, Ambachtstsheer, K., Pension Reform: How Canada Can Lead the World, C.D How Institute, 2009, http://www.cdhowe.org/pdf/BenefactorsLecture_09.pdf

[99] Pg 12, Ibid

market just before retirement can potentially wipe away years of investment gains with little time to salvage the situation.[100]

A dynamic life cycle fund, on the other hand, is responsive to past performance of the portfolio relative to the investor's target return in determining the right mix of assets in future periods. Thus, while initially it invests heavily in equities just as any other lifecycle strategy, the switching to fixed income is not automatic. It only takes place if the investor has accumulated wealth in excess of the target accumulation at the point of switch. Also, after switching to conservative assets, if the accumulation falls below the target in any period, the direction of switch is reversed by moving away from fixed income and towards stocks.[101]

An OECD study on default based on a life cycle principle concludes as follows[102]:

- The relative performance of investment strategies – measured in a risk-adjusted manner - depends on the type of benefit during the payout phase. Life cycle strategies do best when benefits are paid as life annuities and are less valuable when benefits are paid as programmed withdrawals. Dynamic strategies seem to work better with programmed withdrawals. A mixture of life-cycle and dynamic strategies may be required when benefits are paid combining programmed withdrawals and deferred life annuities bought at the time of retirement.

- Life cycle strategies that maintain a constant exposure to equities during most of the accumulation period, switching swiftly to bonds in the last decade before retirement seem to perform best. The value of such strategies stems from the protection of pension benefits from major market shocks in the years preceding retirement.

- The introduction of dynamic investment management strategies can provide somewhat higher replacement rates for a given level of risk than the more deterministic or pre-set strategies, at least in the case of pay-outs in the form of variable withdrawals. Their pro-cyclicality, however, may affect their performance. They tend to sell equities when prices fall and buy them when prices go up, missing in the cumulative return of good times. It is possible that a dynamic strategy that considers the long-term evolution of the equity premium and the nature of mean-reversion in equity returns could capture some gains for pension plan members.

- The length of the contribution period affects the ranking of the different investment strategies. Life cycle strategies perform better than fixed portfolios when the contribution period is only 20 instead of 40 years. Longer contribution periods reduce the implicit attractiveness of life cycle strategies (as the higher replacement rates obtained in crisis periods are offset by lower rates in boom times). For short contribution periods, life cycle strategies and the type of gliding path become more relevant to assure higher replacement rate outcomes in crisis periods.

Two particular options of how a default fund can be introduced are discussed hereunder:

### (01) Establishing a Single Default Fund Established by Government

This model is similar to the Swedish AP7 Default Fund. Under this option, the Government establishes a Default Fund with an established life cycle investment strategy. The management of the Default Fund is contracted out to the private sector and supervised by the MFSA.

The Default Fund would be designed in a manner where a person is automatically enrolled in the event that he or she does not indicate an investment choice for whatever reason.[103] The Default

[100] Pg 4, Basu, A., Byrnes, A., and Drew, E, M., Dynamic Lifecycle Strategies for Target Date Retirement Funds, Discussion Papers Finance, Griffith Business School, Griffith University, No 2009-02
[101] Pg 6, Ibid
[102] Pg 27 – 28, The Use of Default Options in Work Place Personal Pensions and the Use of Group Self Invested Personal Pensions for Automatic Enrolment, Consultation on Draft Guidance, Department for Work and Pensions, United Kingdom, September 2009

Fund would be constituted on the basis of a de-risking mechanism – that is a strategy that mitigates the person's investment volatility appropriately over the lifetime of the pension plan.[104]

employee person may at any point in time opt out of the Default Fund should he or she wishes to engage more actively in the management of his or her pension fund.

(02) Hybrid Occupational Retirement Pension with Mandatory Default Option

Under this option a Mandatory Second Pension framework would be based on the 'pure' ORP framework subject, however, to the condition that amongst the pension fund scheme options that a private sector provider will offer, the provider will be mandated by legislation to offer, inform and discuss with the person who will take up a Mandatory Second Pension a Default Fund based on a life-cycle principle.

The PWG2010 recommends that the Government should invite the MFSA under the direction of ministerial policy orientation to present recommendations on the most appropriate framework for the design and grafting of a Default Fund onto a Mandatory Second Pension.

| **Recommendation 30** |
| --- |
| The 2010 Pensions Working Group recommends that the introduction of a Mandatory Second Pension should be supported by a Default Fund framework based on a lifecycle investment strategy in which people who fail or are unwilling to make an investment choice are de facto enrolled in and that the Government should consider inviting, under the direction of ministerial policy orientation, the Malta Financial Services Authority to present recommendations on the most appropriate framework for the design and grafting of such a Default Fund onto the Mandatory Second Pension Framework. |

#### 05.4.2.2 Safeguarding Retirement Income of a Mandatory Second Pension Scheme Against the Cost of Administration of a Pension Fund

A review of the fees structure that pension providers charge in different jurisdictions shows that this is a complex issue. Fees can be either fixed or variable. A fixed commission is characterised by the fact that the price does not depend on the level of the saving contribution or on the size of the fund. A variable commission may take the form of a percentage of the flow, of either payments or contributions, or of the stock, as a percentage of the amount managed or as a percentage of the cumulative assets turnover – where a variable commission on the flow (normally shown as a % of salary) is the most common.[105]

Variable commission on stock can either be on the value of the fund or on returns. Variable commission encourages pension companies to maximise assets by maximising returns. A potential danger with this type of commission is that it may encourage a pension provider to adopt investment strategies which are profitable in the short term but may be detrimental against the fundamental goal of maximising results in the long term in order to guarantee subscribers an adequate pension – an accusation levied at financial institutions that has been heard often in 2008 and 2009 in the wave of the financial and economic crisis.

Additionally, pension companies may also charge exit fees when workers transfer their individual accounts to another pension provider. This could be countered by rules with regards to transfers.

Different jurisdictions adopt different structures for charges and balances between fees on contribution and asset management fees. Australia provides for a fixed commission, fees on

[103] Pg 10, The Use of Default Options in Work Place Personal Pensions and the Use of Group Self Invested Personal Pensions for Automatic Enrolment, Consultation on Draft Guidance, Department for Work and Pensions, United Kingdom, September 2009
[104] Pg 12, Ibid
[105] Pg 4, Tapia, W., and Yermo, Y., Fees inn Individual Account Pensions Systems: A Cross-Country Comparison, OECD Working Papers on Insurance and Private Pensions, No 27, OECD, 2008

contribution, fee on asset, and a switching / exit fee. Sweden, on the other hand, provides only for a fee on assets.

It so follows, that the higher the fee that pension providers charge and the higher the administrative cost for the management of the fund the higher is the negative impact on the retirement income of participants in that fund. How then can pension service providers by regulated or structures designed in order to reduce to the extent possible the cost of a Pension Fund?

Poland, for example, has successfully introduced price caps to lower fees. Prior to 2004, the management fee was subject to an upper limit of 0.6% of individual account balances, whilst contributions fees were not capped. In 2004, changes were introduced to cap both the management fee (0.54%) and the up-front fee (7% to be reduced to 3.5% by 2014). Further limits were placed on the management fee related to the overall size of assets under management - with the fixed component of the management fee to be lower than 0.045% of net assets, while the variable component of the management fee limited to a maximum of 0.005% of net assets per month.[106]

In Sweden, on the other hand, whilst there are no limits on fees, fund managers are obliged, under the agreement between them and the Pensions Authority to offer a rebate on their ordinary fees for retail investors.

Moreover, the Pensions Authority acts as a 'clearing' house in order to reduce the cost of administration that is set by providers. It does this in two ways. First it acts as the entity that collects the contributions from the employers and thereafter channels this revenue to the appropriate pension provider. Second, it acts as the channel between daily changes in investment profiles made by a contributor to their pension fund and the forwarding of such changes to the pension providers.

The fee levels in different jurisdictions vary. In the Slovak Republic the net fee on contributions is 0.09% and the fee on assets is 0.85%. In Sweden the fee on assets ranges from 0.42% to 1.21% whilst in Australia this ranges from 0.7% to 2.53%. In 2007, the administrative charges as a % of total assets stood as follows[107]:

**Table 32: Administrative Charges as % of Total Assets, 2007**

| % | Country |
|---|---|
| 0.48 | Sweden |
| 1.25 | Australia |
| 1.25 | Latvia |
| 1.52 | Estonia |

Source: OECD

The differences in the fee structure between one country and the other is primarily determined by the maturity and size of the system, asset allocation and investment regulation, competition amongst pension providers.

In this regard, the PWG2010 is concerned that the administrative charges for the management of an ORP Second Pension framework may result in a high charge on the administration of the pension funds and thereby significantly eroding into pension returns given that:

01. Malta is a small market, and the introduction of a Mandatory Second Pension will be subject to economies of scale.

[106] Pg 7, Ibid
[107] Pg 11, Ibid

02. An open approach to competition may result in a situation where either there is little response by the private sector to participate in this market which may result in a private monopolistic or duopoly market or potentially the participation of a high number of private sector providers which may subsequently result in market adjustment which may negatively impact those participants with providers who may be forced out of the market.

The PWG2010 is of the considered opinion that the fees charged by private pension providers are such that they will considerably reduce the retirement income of participants. 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%. In fact the UK Pensions Commission suggested that there could be an annual management charge of 0.3 per cent in the long run.

The PWG2010 notes the OECD conclusions that the "cost advantages of the Swedish and Bolivian systems stems largely from a decision to force cost competition among providers via a central agency or 'clearing house"[108] The PWG2010 is not, as this stage, in a position to determine whether the approach adopted by Sweden is an approach that can be replicated in Malta.

Thus, the PWG2010 recommends that the Ministry for Pensions and MFSA should carry out a review on the mechanism that Malta is to adopt in ensuring that the appropriate administrative cost structure is the optimal one that can be secured. Such a review would evaluate, amongst others the:

- introduction of a fee capping structure; or
- establishment of the Department of Inland Revenue to act as a clearing house.

**Recommendation 31**

The 2010 Pensions Working Group recommends that Ministry for Pensions and the Malta Financial Services Authority should carry out a review by the earliest possible on the mechanism that Malta is to introduce to ensure that the most optimal administrative cost structure for the Mandatory Second Pension is introduced as otherwise the real danger exists that pension returns would be significantly eroded. Such a review would evaluate, amongst others the:

- introduction of a fee capping structure; or
- establishment of the Department of Inland Revenue to act as a clearing house.

[108] Pg 3, Ibid

# Chapter 06: Establishing a Third Pension Framework and Introducing Alternative Voluntary Mechanisms for Saving for Retirement

## 06.1 Establishing a Third Pension Framework

The challenge of the pension reform initiated in 2004 and under continued review through this Report is that of securing a balanced pensions system that does not simply ensure a universal minimum standard of living for persons in retirement. Rather, the pensions system must seek to minimise the gap between the pension received and the average wage paid over time so that a retired person's standard of living remains, to the extent possible, at least in sight of that enjoyed during his or her working life. This, however, is to be achieved in a financially sustained manner.

The PWG had proposed that the Government should introduce a Third Pension framework. Although provisions in the SSA were introduced to accommodate the introduction of a Third Pension framework its implementation is yet to materialise.

The reasons of why Government has not introduced the Third Pension framework – which provides a person with the voluntary choice to enter into a pension plan – are not understood.

Although this Report recommends that Government should introduce a Mandatory Second Pension at the earliest possible, the PWG2010 is recognisant of the fact that considerable preparatory work is required for the Mandatory Second Pension to be introduced – work which will require time.

Thus, the PWG2010 is of the considered opinion that the Government should consider introducing the Third Pension framework as early as possible in 2011 in order to provide the appropriate vehicle for persons to save for their pension voluntary should they wish to do so.

| Recommendation 32 |
|---|
| The 2010 Pensions Working Group recommends that Government should consider introducing the Third Pension framework as early as possible in 2011 in order to provide the appropriate vehicle for persons to save for their pension voluntary should they wish to do so. |

Given that a Third Pillar framework will be introduced prior to a Mandatory Second Pension the PWG2010 considers it to be of strategic importance that a Third Pillar framework is designed in such a way to facilitate persons who invest in it to be able to migrate into the Mandatory Second Pension should they wish to do so.

This is considered to be of strategic importance as otherwise people may decide against investing in a Third Pension if they fear that they would have to pay an additional savings contribution once the Mandatory Second Pension is introduced.

| Recommendation 33 |
|---|
| Given that a Third Pension framework will be introduced prior to a Mandatory Second Pension the 2010 Pensions Working Group considers it to be of strategic importance that a Third Pillar framework is designed in such a way to facilitate persons who invest in it to be able to migrate into the Mandatory Second Pension as otherwise people may decide against investing in a Third Pension if they fear that they would have to pay an addition saving contribution once the Mandatory Second Pension is introduced. |

The key concern with regards to a Third Pension framework, which by its very nature is voluntary, is that when persons are faced with a choice of whether to invest in a pensions plan behavioural studies show that too often people take decisions with regards to their lives on the basis of the 'here and now' as against the future – 'retirement' for new entrants in the labour market, for example. Is decades away.

Inevitably, an end result is that persons fail to take steps to save for their retirement – which in turn will result that they will fail to maintain their incomes and life styles after retirement given that to a large cohort of the population the primary source of retirement income will be the First Pension.

A report issued by the Department for Work and Pensions of the UK titled 'Savings For Retirement: Implications of Pensions Reforms on Financial Incentives to Save for Retirement'[109] identifies the following as barriers to saving:

| | |
|---|---|
| Inertia | Considered as a key factor that has been explored by economists. Given that retirement savings relates to something so far in the future, it is a decision that is very likely to be put off until tomorrow. The way that options are presented to individuals and the effort required in taking action can have significant impacts on behaviour. |
| Myopia | In contrast to economic theory, individuals are often observed spreading their financial resources over only relatively short timeframes, particularly at younger ages. Without triggers to encourage thinking about retirement and with pressing financial and other constraints, many people may focus on meeting work-age financial needs without considering their retirement saving. |
| Hyperbolic Discounting | Individuals do not discount the future at a constant rate, so that their preferences for future consumption are not consistently related to preferences for current consumption. This can lead to expectations for future needs not being met – people may prefer to consume more now but when they get to later life they become unhappy with their previous decisions. |
| Bounded Rationality | Pension decisions may be too complex for individuals to solve on their own, particularly as some individuals may have low financial capability. Thus, they make decisions that may not be fully optimal. To reduce the effort (and the cost) of making complex decisions, individuals may use 'rule of thumb' rules to help choose when and how to save. |
| Habits | Individuals are habitual, which can explain why people do not react to changed financial incentives, even if it would be rational and financially beneficial for them to alter their behaviour. |
| Loss Aversion | Individuals are also often adverse to losing money and may often accept lower positive returns in order to avoid negative ones, even if they may be risk takers when it comes to situations where there are no loss possibilities. |
| Herd Mentality | Individual decisions are often made by observing and copying others, particularly if this reduces the effort required to carry out a full rational analysis of all the available options. |
| Mental Accounting | Individuals may also follow norms of 'mental accounting' to help conceptualise their financial obligations, for example, having different savings accounts for different persons. This means that it is less easy to predict how current consumption will respond to gains in income as the result is dependent on which account the individual allocates the gain to. |

[109] Pg 37, Savings For Retirement: Implications of Pensions Reforms on Financial Incentives to Save for Retirement, Research Report No 558, Department for Work and Pensions, 2009

It is pertinent to underline that an OECD study titled 'Coverage of Funded Pension Plans'[110] shows that coverage in funded voluntary pension plans is well above 50% in most countries considered. The study shows that in Canada, Ireland, the UK and the USA, where funded pension private plans are voluntary and the benefit coverage of public schemes is relatively low the share of persons who are members of a voluntary funded pension plan is more than half of the employed population – around 60%.

In Finland and Norway, however, where PAYG financed pensions plans provide a relative large replacement rate (similar to Malta where to date the PAYG provides the only replacement rate) coverage in a voluntary funded personal pension plans is relatively low – standing at 7.3% and 3.0% respectively.[111]

A similar concern arises with employers contributing voluntary in an ORP scheme. It is, considered, highly unlikely that in a voluntary pensions framework that an employer will voluntarily introduce a Second Pension where the employer will match in part or in full the voluntary contribution paid by the employee – although there may be instances where such OPR schemes are introduced as part of collective bargaining negotiations (potentially in lieu of other benefits) or because of scarcity of highly skilled personnel and hence the employer seeks to attain a competitive edge in attracting and retaining such skills.

The key instrument applied in other jurisdictions to propel employers and persons to invest in the setting up OPR schemes and in contributing to such schemes is to provide preferential tax treatment of pension plans compared to other forms of savings. This differentiation is of importance. The purpose of providing tax incentives to pension plans is not that of encouraging savings per se, but of promulgating an efficient size of savings for use during the retirement phase of a person's life cycle.

From a government perspective, the underlying rationale of why a government should introduce such preferential tax treatment of pensions' plans is that encouraging individuals to increase their retirement wealth could be considered as action 'in the public interest'. The financial cost to a government stemming from the cost of the incentive, the deferment of tax revenue (direct and indirect today) is more than offset by the potential burden that the future generations may face in having to finance, by means of taxes, a larger pension GDP % in order to secure an 'adequate' pension level as provided by the PAYG – the First Pension; as well as ensuring that an aged population will have sufficient income to stimulate the economy.

The theoretical rationale of introducing a tax advantage to a retirement saving instrument is that, in most cases, this results in a modest increase in the rate of return to that particular asset. The return is 'modest' as most tax incentives to pension saving schemes are associated with a tax referral or at most a partial tax exemption – rather than a complete exemption from taxes.

Most often, therefore, pension saving incentive schemes are designed in a manner where a person is partially exempt from taxation on income that is contributed to a given scheme (often within a certain limit) but they are subsequently taxed when those resources are drawn from the savings at retirement. Alternatively, if interest payments, capital tax gains, and withdrawals are untaxed, then contributions to such pension saving schemes are typically made out of taxed income. The former design is best expressed by the Individual Retirement Account in the USA; and the latter is that of the TESSA and ISA in the UK and the ROTH in the USA.

**Table 33** below demonstrates types of tax treatment on retirement savings on the basis of 'EET' notation of deferred taxation where:

| | |
|---|---|
| E | Tax Exempt |
| P | Partially Exempt / Partially Taxed |
| T | Taxed. |

[110] Antolin, P., Coverage of Funded Pension Plans, OECD Working Papers on Insurance and Private Pensions, No 19, OECD Publishing, 2008
[111] Ibid. Data source reference for Finland is 1998 and for Norway 2002.

**Table 33: Types of Tax Treatment on Pension Savings**

| | Germany | France | Italy | Spain | Netherlands | UK |
|---|---|---|---|---|---|---|
| | EEP | EEP | EPP | EET | EET | EET |

Without seeking to enter into a complex underpinning theoretical hypothesis on the effectiveness of tax incentives as instruments to stimulate pensions saving, for such effectiveness to be achieved at least one of the following two criteria must be met.

First, personal savings must be sufficiently elastic to the net rate of return. If this is so, the higher returns provided by the tax-preferred pension plan can then produce a net flow of additional savings. The degree of savings elasticity is an empirical issue, since economic theory based on the traditional life cycle hypothesis cannot provide insight into the size or direction of this relation.

The idea itself of a general interest elasticity of saving can hardly be conceived in a behavioural context if the usual prerequisites of complete rationality in inter-temporal decision making, full information, and the self control of the individual in carrying out plans that mean the fore-going of short term decisions relating to one's quality of life.

Second. Tax incentives should be capable of influencing the portfolio decisions of savers, inducing them to replace taxed with non taxed assets. If there is perfect substitutability among different assets, then even a small spread between returns induced by a tax incentive will lead to the complete substitution of forms of savings.

The key issue that arises in this regard is whether the degree of the incentivised increased savings in pensions' retirement schemes is truly 'new' savings – deferred from consumption behaviour – as against a substitution savings from existing savings instruments into the new incentivised pensions' retirement schemes.

There is a wide array of economic studies that seek to determine the effectiveness of the application of tax incentives to stimulate retirement savings. A review of such studies shows that assessment of the economic effectives of such instruments is contradictory – in part as such assessments are country specific.

For example a study carried out by the Centro do Analisi delle Politiche Pubbliche on the role of tax incentives in voluntary pension schemes in Italy which is based on an EPP framework concludes that "tax incentives alone are not the most effective instrument with which to promote pension saving plans, particularly if the target cohorts include poorer, younger people faced with liquidity constraints".[112]

An OECD study on the Riester tax-favoured voluntary retirement savings introduced in 2001 concluded that not sufficient time had passed to make a conclusive assessment. Nevertheless it adds that:

> "The paper unfortunately adds little to the core question, whether tax relief creates additional new savings … While we do know that subsidies strongly increase saving in the specific form that is subsidised, possibly to the detriment of other saving forms, we do not really have firm evidence that saving related tax relief or similar subsidies increase total saving in Europe.
>
> This does not make tax relief a potentially wasteful instrument. Even if a tax relief would only shift other saving to retirement saving, this may be a valuable mechanism if the government wants to make sure that the elderly will have a generous multi-pillar retirement income. That is, if the government does not believe in the creation of new saving for macro-economic purposes, it still may want to repress procrastination not only in form of consumption now, but also in the form of a larger house in the near future, and subsidise retirement consumption in the far future."[113]

[112] Pg 9, Bosi, P., and Guerra, M. C., The Role of Tax Incentives in Voluntary Pension Schemes In Italy: What Can Other Countries Learn from This?, Paper presented to the Fourth International Forum of the Collaborating Projects on Aging Issues, Tokyo, Centro di Analisi delle Politiche Pubbliche, 2002,

[113] Pg 137, Borsch-Supan. A., Mind the Gap: The Effectiveness of Incentives To Boost Retirement Saving in Europe, OECD Economic Studies No 38, 2004/2, OECD 2005

A different study by OECD which looked at the tax incentives introduced for the IRAs in the USA and the Tax Exempt Special Savings Accounts (TESSAs) and the Individual Savings Accounts (ISAs) in the UK "suggests that, at the most, only relatively small fractions of the funds going into tax-advantaged savings vehicles can be considered to be 'new' savings'". The study adds:

> "As such, the best interpretation of the evidence is that such policies are expensive ways of encouraging savings. In addition, to the extent that the reshuffling of assets leads to a reduction in tax liabilities without any real change in economic behavior, there is some deadweight loss associated with such policies. Additionally, since those with the greatest reshuffling possibilities are the wealthier members of society, these policies will typically have some distributional impact. A priori we would expect these factors to be biggest for IRAs and TRRAs, where the liquidity restriction would be likely to prevent savers with low wealth from participating. As such the introduction of the ISAs in the UK is an important episode, showing, as it does, that even when such accounts do not include minimum holding periods the extent to which they encourage genuinely 'new' saving is limited."[114]

A report by the Pensions Policy Institute on behalf of Age Concern England titled 'Tax Relief and Incentives for Pension Savings' also concludes that the effectiveness of the TESSAs and ISAs pension savings tax incentive schemes is unproven given that there is no evidence that tax incentives increase the overall level of savings. It concludes that the primary reasons for this are (a) the tax incentive schemes are complex and thus difficult to understand which in turn acts as an obstacle to their take-up; (b) the tax incentives do not appeal to the right target group; and (c) the amount that people seek to save is determined by a range of factors that are not linked to tax relief or rates of return.[115]

As shown above, economic theoretical and empirical evidence on the successful impact of tax incentives to stimulate increased pension savings is not conclusive. The main argument raised in the literature reviewed against the introduction of such a scheme is that there is very limited empirical evidence that such tax incentives schemes have, in essence, created 'new' savings.

The PWG2010, has reflected on the economic reviews and empirical studies and the various and different conclusions reached. The PWG2010 argues, however, that the situation in Malta is different from most countries which have been empirically studied. Malta has, to date, only one pension pillar – the PAYG. It has no voluntary Third Pension mechanism – let alone a mandatory one. As discussed earlier in this Report, Maltese are saving less – with a degree of this saving reduction being replaced by mortgage payment.

Thus, unlike other countries, Malta is yet to build a framework that, at the first instance, provides people with the option to save for their retirement; and subsequent to this to build a culture for saving for retirement.

The building of a culture for saving for retirement will not be easy to achieve: it requires education, information, understanding of consequences, changes in habits and life style behaviour. Nor will such a change occur overnight. It will take time. In this regard, the PWG2010 is of the considered opinion that, in embarking upon the building of a culture of savings, the Government should consider putting together a tool-box of instruments which should include tax incentivisation for voluntary pension savings instruments.

In a state of play where Malta is yet to initiate a culture of saving for retirement, the PWG2010 is of the considered opinion that the creation of a situation where 'new' savings may be marginal at best, and that savings into pension retirement savings funds would be a form of substitution to other saving mechanisms should not be considered as an impediment to embark upon such incentivisation.

It is pertinent to emphasise that a pension savings instrument is a long term mechanism that 'locks' the savings made by the said person until he or she retires. This contrasts with traditional saving mechanisms such as a savings account and, potentially, fixed term accounts given that with such accounts the 'fixed' term is as decided and entered into by the account holder.

---

[114] Pg 166, Attansio, O, P., Banks, J., Wakefield, M., Effectiveness of Tax Incentives to Boos Retirement Saving: Theoretical Motivation and Empirical Evidence, OECD Economic Studies No 39, 2004/02, OECD 2005

[115] Pg 11, Curry, C., and O'Connell, A., Tax Relief and Incentives for Pension Savings, Pensions Policy Institute, Age Concern England, October 2004, www.pensionspolicyinstitute.org.uk

Thus, if the introduction of a tax incentive framework for the pension instruments discussed earlier in this Report creates a shift that substitutes savings and fixed terms saving instruments – to mention two examples – by locked pensions retirement savings then such a framework would have had a positive spur on the building of a culture of savings and for initiating the creation of culture where a person prepares him or herself for the retirement phase of one's lifecycle.

This would be so, because persons would position their savings in locked environments for use only on retirement, rather than maintaining flexibility – potentially with a view to retain them for retirement purposes – but subject to use in the current life cycle period in accordance with behavioural decisions relating to life style choices.

| **Recommendation 34** |
| --- |
| The 2010 Pensions Working Group recommends that given that Malta is yet to establish instruments for saving for one's retirement let alone building a culture for saving for one's retirement there is merit that in the building of such a culture the Government may wish to consider putting together a tax incentives framework to spur people to invest in a Third Pension. |

The PWG2010 has, in the drawing up of this Report, sought to undertake modelling to determine a potential tax incentive framework for Malta that would stimulate persons to invest in the proposed voluntary pensions retirement schemes discussed above.

From a tax incentive design point of view, within the ambit of a Third Pension, there is no doubt that the introduction of such a framework should be biased towards introducing up front tax as against tax benefits upon the maturity of the pension retirement savings once a person retires.

Similarly, stimulating ORP schemes wherein an employer will match, in part or in full, a contribution paid by an employee into the voluntary ORP scheme would require a tax incentive design that would provide tax relief from annual payment of taxation in accordance to, in part or in full, the contribution matched by the employer.

It is also argued, that an up-front tax incentive design could also be considered to attract persons who have already invested in endowment and other profit and unit linked policies to extend the value of these policies into a retirement savings scheme upon maturity – as against consuming such investment upon maturity on matters that are not linked to his or her retirement lifecycle period.

It is pertinent to underline that financial service providers today sell financial products on the basis that the investment upon maturity is tax free. This is not correct: what actually happens is that the provider pays 15% withholding tax on the maturity value and subsequently presents to the investor the remaining 'net' maturity value of the investment as *the* net maturity value.

The PWG2010 proposes that the Government should consider introducing a fiscal incentive regime for the Third Pension framework on the following basis:

| Condition | Contribution | Maturity | Private Pension Plan generated income or annuity |
| --- | --- | --- | --- |
| Investment is locked up to retirement | Exempt | Exempt | Taxable |

The PWG2010 modelled various scenarios of a tax incentive instrument to determine the potential financial impact of such a scheme. The PWG2010 did not have access to the appropriate skills to determine that elasticity of €1 tax incentive on the additional increased in savings for retirement.

For example, the financial impact to Government of an annual deduction incentive of €2,000 (which represents a high end premium for a life insurance product) for contributions paid into a Third Pension is seen to be as follows:

### (a) Tax Deduction on Contribution

(i) Single Tax Assessment

Information from the Department of Inland Revenue shows that if all persons who compile a single tax assessment apply for a tax deduction, provided in this example, the tax loss to Government will be €21.9m annually.

In undertaking this model it is assumed that take up would primarily be from persons who are 45 years or younger given that pension funds need time to mature into a considerable investment fund as well as a 20 year period allows for the neutralisation of market ups and downs. If all 45 years and younger apply for a tax deduction, the tax loss to Government will be €15.7m annually.

Assuming a 15% take up from this cohort – which is perceived to be on the high side – the tax loss to Government will be €2.35m annually.

(ii) Joint Tax Computation Assessment

Information from the Department of Inland Revenue shows that if all those persons who compile a joint tax computation assessment apply for a tax deduction the tax loss to Government will be €14.7m annually. With regards to this category, it was assumed that the tax deduction incentive is only applied to one person.

If all 45 years and younger apply for a tax deduction the tax loss to Government will be €5.7m annually. Assuming a 15% take up from this cohort the tax loss to Government will be €857,000 annually.

(iii) Separate Tax Computation Assessment

Information from the Department of Inland Revenue shows that if all those persons who compile a separate tax computation apply for a tax deduction the tax loss to Government will be €9.5m annually.

If all 45 years and younger apply for a tax deduction the tax loss to Government will be €5.4m annually. Assuming a 15% take up from this cohort the tax loss to Government will be €815,000 annually.

### (b) Removal of Tax on Maturity

On the basis of an EET tax incentive framework the current 15% Withdrawal Tax upon the maturity of the investment is withdrawn in so far that the investor does not take a lump sum withdrawal upon retirement. This part of the fiscal incentive is neutral given that the set of investments are yet to be made, the Government only receives the tax contribution upon maturity.

In the event that an investor decides to exercise his or her option to withdraw a lump sum of up to 25% of the maturity value than the 15% Withdrawal Tax will continue to apply on that portion that has been withdrawn. This too is tax neutral on current Government finances.

### (c) On Payment of Annuity or Pension Income

Upon the receipt of the monthly annuity or pension income from the pension fund, the pensioner will pay a 15% Withdrawal Tax.

**Recommendation 35**

The 2010 Pensions Working Group recommends that the Government should consider introducing a fiscal instrument directed to incentivise persons to invest in savings for their retirement through a Third Pension that is designed on the following basis that the:

(i) fiscal instrument is in the form of a tax deduction

(ii) contribution is tax exempt;

(iii) maturity value is tax exempt;

(iv) annuity or income received is taxable.

Discussions with stakeholders lead the PWG2010 to conclude that the Income Tax Act should be reviewed to ensure that it reflects contemporary tax principles that relate to pension funds particularly given that the provisions in the Act in this regard were never applied as private pension funds have not been operational since 1979. Moreover harmonisation should also take place between the Income Tax Act and other related legislation.

**Recommendation 36**

The 2010 Pensions Working Group recommends that the Government should consider reviewing the Income Tax Act with regards to provisions related to private pensions and to harmonise such provisions with other appropriate related legislation.

## 06.2 Creating a Fast Track Route to Individual Private Pension Accounts

The PWG, in its Final Report, had proposed that persons who today have already voluntary decided to invest in a particular type of financial services product which are subject to an annual premium should be provided with the option to decide whether they wish to lock such products into an individual private pension scheme upon their maturity.

The financial services products that can be considered for conversion into an individual private pension scheme are shown in **Table 34** below. As can be seen there is a considerably large number of individuals who have voluntarily invested in such schemes.

**Table 34: Insurance Contracts / Products Proceeds which can be Locked into Pension Instruments: 2007**

| Product Type | | No of Policies | Amount of Benefits €000's |
|---|---|---|---|
| With-profits non linked | Endowments | 1,640 | 27,431 |
| Non-profits non-linked | Endowments | 520 | 2,152 |
| Non-profits non-linked | Convertible Term Assurance | 563 | 23,884 |
| Accumulated with-profits | Endowments | 50,139 | 636,287 |
| Property linked contracts | Unit-linked | 24,033 | N/A |
| Index linked contracts | Capital Redemption | 409 | 6,170 |

Note: The reported amount of benefit under unit-linked products is the life element, under which benefits is given upon death of the policyholder should this occur before maturity and if the nominal value of units is less than a pre-specified minimum amount when death occurs. The amount which could be locked into an annuity upon maturity is the investment element of unit linked products which is an unknown amount.

Source: Malta Financial Services Authority

In discussions with the Malta Insurance Association the PWG2010 was informed that in the forthcoming decade a large number of these instruments will mature. One particular insurance firm has informed the PWG2010 that between 2010 and 2014 the total maturity / surrender value of the investment it holds will be €187m.

**Table 35: Maturity / Surrender Value of Financial Instruments held by One Provider**

| Year | Maturity / Surrender Value |
|---|---|
| 2010 | €34,000,000 |
| 2011 | €36,000,000 |
| 2012 | €40,000,000 |
| 2013 | €34,000,000 |
| 2014 | €43,000,000 |

Source: Malta Insurance Association

Similarly a major bank informed the PWG2010 that the total maturity / surrender value for the period 2010 to 2020 will be €281.7m.

**Table 36: Maturity / Surrender Value of Financial Instruments held by One Financial Services Provider**

| Year | Maturity / Surrender Value |
|---|---|
| Saving Plans | €132,000,525 |
| Single Premium | €75,768,215 |
| VIP Reg+PRP | €68,181,848 |
| VIP Single | €5,703,646 |

It clearly emerges that the introduction of an option which allows holders of such financial products to choose to roll over the surrender value by locking them into an individual private pension funds, on maturity, until a person reaches retirement age could have a significant positive impact in accelerating the process of introducing savings for retirement in private pension funds within the short term.

The introduction of such a scheme could be based on the following principles:

- that a person decides whether to take the full surrender value of his or her financial services product or whether he or she locks proceeds for a private pension plan and subsequently rolls over the plan on maturity until he or she reaches retirement age where-in the surrender value is directed towards a private pension plan.

- that a person has the option to withdraw as a lump sum up to a maximum of 25% of the proceeds upon retirement age and the person locks the remaining 75% within a private pension plan.

- that in the event that, at a later stage, the Government introduces a Mandatory Second Pension the annual premium paid on the financial product would constitute all or part of the mandatory contribution set.

- that in the event of the death of the individual, the next of kin would have the option:

    - to liquidise the scheme in the event the such death occurs during the period of rolling over the financial instrument; or

    - to continue to receive the pension in the event that it is locked within a private pension scheme.

The PWG2010 recognises that such a scheme will only succeed if it is supported by an attractive fiscal incentive regime. If the Government had to adopt a scheme that incentivises the conversion of

**existing** financial instruments, as discussed earlier into pension fund as they mature there will be a tax deferment impact on public revenues given that tax will not be collected on maturity as happens today but on the monthly receipt of the annuity or pension income, or on the lump sum taken on the official retirement date.

The PWG2010 was not in a position to assess the quantum of the tax that will be deferred. Nevertheless, the PWG2010 is of the considered opinion that an opportunity exists to fast track the creation of pension saving funds and that the Ministries for Pensions and Finance respectively together with the appropriate stake holders should undertake the necessary analysis to present a recommendation to Government by 2012.

| **Recommendation 37** |
|---|
| The 2010 Pensions Working Group is of the considered opinion that an opportunity exists to fast track the introduction of pension savings accounts by incentivising the conversion of existing financial products on maturity into locked pensions savings and recommends that the Government should consider working with appropriate stakeholder to devise a way forward in this regard by 2012. |

## 06.3 Leveraging Mortgage Investment in Home Ownership into Income During Retirement

The 2005 Census shows that, between 1995 and 2005, the total number of private households increased from 119,479 in 1995 to 139,178 in 2005. In this regard home ownership increased from 68.0% in 1995 to 75.2% in 2005. Moreover as is shown in **Table 37** below, the number of mortgages continued to increase in 2006 and 2007 – although the growth of rate in total lending for mortgages decreased from 21.16% in 2005 to 16.33% in 2006 and continued to decrease in 2007 to 13.84%.

**Table 37: Number of Mortgage Accounts: 2003 – 2007**

| Year | Number of mortgages (accounts) | Total amount in Lm ('000s)^ | Interest Rate (%) |
|---|---|---|---|
| 2003 | 38,538 | 442,245 | 4.47 |
| 2004 | 41,981 | 539,092 | 4.30 |
| 2005 | 44,990 | 653,136 | 4.49 |
| 2006 | 47,055 | 759,837 | 4.95 |
| 2007 | 48,516 | 865,005 | 5.39 |

Note: ^stock value.

Source: Central Bank of Malta

**Table 38** below shows the behaviour of mortgage lending between 1985 and 2007. It is immediately clear from the data that lending for the purchasing of housing enjoyed an uninterrupted increase during the period under consideration.

**Table 38: Lending for Mortgages**

| *Year* | *Total Resident Lending for House Purchases* | *% age change over previous year* | | *Year* | *Total Resident Lending for House Purchases* | *% age change over previous year* |
|---|---|---|---|---|---|---|
| | EUR 000s | | | | EUR 000s | |
| | | | | | | |
| 1985 | 87,798.74 | | | 1997 | 404,588.87 | 14.90% |
| 1986 | 97,943.16 | 11.55% | | 1998 | 454,353.60 | 12.30% |
| 1987 | 108,287.91 | 10.56% | | 1999 | 521,986.96 | 14.89% |
| 1988 | 126,606.10 | 16.92% | | 2000 | 600,845.56 | 15.11% |
| 1989 | 150,104.82 | 18.56% | | 2001 | 714,470.07 | 18.91% |
| 1990 | 180,125.79 | 20.00% | | 2002 | 855,168.88 | 19.69% |
| 1991 | 196,662.01 | 9.18% | | 2003 | 1,030,153.74 | 20.46% |
| 1992 | 219,629.63 | 11.68% | | 2004 | 1,255,700.00 | 21.89% |
| 1993 | 230,340.09 | 4.88% | | 2005 | 1,521,400.00 | 21.16% |
| 1994 | 279,597.02 | 21.38% | | 2006 | 1,769,900.00 | 16.33% |
| 1995 | 308,779.41 | 10.44% | | 2007 | 2,014,900.00 | 13.84% |
| 1996 | 352,122.06 | 14.04% | | 2008* | 2,166,500.00 | 7.52% |

Source: National Statistics Office / Central Bank of Malta

* Figures available as at 30th September, 2008.

As discussed earlier the mortgage seems to be a form of substituting savings by households and the payment of the mortgage constitutes a considerable part of a household's disposal income.

In essence this means that, to the large majority of persons, the ownership of a home constitutes the main asset of a household – with income invested in the payment of the mortgage over the period that the mortgage is to be paid.

It also means that, for a considerable number of households, the remaining disposable income following the payment of a mortgage may be such that they would find it difficult to voluntarily invest in a private pension in order to boost the income that would be available to them over and above the PAYG pension once they retire.

Hence, a most likely outcome if these conclusions are correct is that a considerable number of persons will, on their retirement, end up with an asset portfolio that consists of a fully owned home but limited liquid savings.

Can wealth invested in a property, however, become a suitable source of retirement income? One primary way property can be used to increase or fund income during retirement is through the sale of the house: although this would mean that a person will have to finance a new, potentially, smaller home (on which he or she would have to pay the full Capital Gains Tax on both the sale of the old and purchase of the new house respectively) or in the event of functioning rental market rent a property.

It is, however, pertinent to underline that a number of countries have introduced financial services products know as equity release instruments which enable a home owner to draw down some of the equity in the property. The HM Treasury defines equity release plans as:

> "Financial products, or sale and lease arrangements, that allow home owners to release the value of their property above any amount owed on a mortgage. These schemes involve a provider giving the home owner either a lump sum or income (or both) on the basis of the value of the home. Providers receive their returns when the home is sold or vacated".[116]

There are two main types of equity release plans: (a) Home Reversion Schemes; and (b) Life-time Mortgages / Mortgages-Backed Equity Release Plans. These are discussed in detail in Supplementary Paper Number 04 titled 'Use of Property during Retirement'.

The PWG2010 is of the considered opinion that the provision of a regulated equity release framework as a further option to a person who has reached retirement to allow him or her to boost his or her retirement income without the need to sell his property during his or her and his or her spouse's lifetime should be studied for implementation by the Ministry for Pensions and the MFSA respectively. Furthermore, it is recommended that the study on the introduction of regulated equity release products is finalised by end 2011 and that the study looks at:

- whether a specific legal framework would be required and whether amendment to the law of succession is required.
- the design of a regulatory regime that would ensure the proper conduct of business by entities providing such products as well as securing robust protection of consumers.
- the implication of equity release products in relation to taxation and succession duties.

In putting forward this recommendation the PWG 2010 tempers its position with two notes of caution. First. The introduction of home ownership schemes may result in the concentration of a high stock of property in the hands of a small number of private sector players.

It further underlines that although there is no regulated home equity release market in Malta the PWG2010 is of the considered opinion that home equity releases between individual property holder and third party market players is already taking place.

Thus, the PWG2010 is of the considered opinion that in formally introducing a home equity release market the competent authority as well as Government should not only introduce the most appropriate regulatory framework for the schemes introduced but should also set rules and governance mechanism to safeguard against property ownership concentration.

Second. Although the local housing market has traditionally proven to be stable and has rarely, if ever, experienced a negative equity collapse, as experienced in countries such as the UK, Spain, et al, this does not mean that such a state of play may never take place in Malta. Thus, a further facet of the proposed study should be to gauge the risks that retirees investing in a home ownership pension product may be susceptible to.

[116] Use of Property for Retirement, Technical Team to the Pensions Working Group, May 2009

**Recommendation 38**

The 2010 Pensions Working Group recommends that the Ministry for Pensions and the Malta Financial Services Authority should consider studying the introduction of a regulated home equity release market directed to allow a person to boost his or her retirement income without the need to sell his or her property during his and his spouse's lifetime – which study should amongst others assess:

- whether a specific legal framework would be required and whether amendment to the law of succession is required.
- the design of a regulatory framework that would ensure the proper conduct of business by entities providing such products as well as securing robust protection of consumers.
- the introduction of appropriate governance mechanisms to prevent concentrated ownership of property by a limited number of private sector operators.
- the risks and mitigation thereof of persons adopting home ownership products upon retirement.
- the implication of equity release products in relation to taxation and succession duties.

## 06.4 Establishing A Pensions Saving Culture A Birth

The SSA, Article 76A states that it is "the right of every child to have an allowance paid out in his respect to the head of household…".

The Children's Allowance (CA) benefit provided in terms of such a child's 'right' is subject to a means test on income, for children under the age of 16 years. Following the reforms to the CA benefit scheme in January 2008 all children of an eligible beneficiary are provided with an allowance that is 6% for each child.

The CA system is two tiered. In the case of a family whose declared income for the previous year is greater than €23,923, the fixed CA per child per annum is €250. In the case of a family where the declared income is less than €23,923, the CA is calculated on the percentage of the difference between the €23,923 and the declared income. At no point in time is the CA paid for each child less than €250 annually.

Moreover, the CA continues to be paid in respect of children between the age of sixteen and twenty one years where the child is either (a) still attending full time education and is not receiving any stipend or remuneration; or (b) the child is registering for his or her first employment under Part I of the Employment Register. It is also to be noted that no income tax is paid on the CA received.

The PWG2010 is of the considered opinion that the CA allowance system is reformed so that it can also become a voluntary vehicle to finance, from a child's birth, a pensions account for the said child.

In part, the creation of a voluntary Child Pensions Account financed by the CA would secure a far more faithful application of the child's "right" as established under the SSA as the CA would safeguard, in part, a financing of the child's life cycle: in this regard saving for the child's eventual retirement age.

A proposed voluntary Child Pensions Account system could be designed on the following parameters:

- A Child Pensions Accounts is opened by the DSS for a child at the request of the parents of the child. The DSS would seek to leverage, either by means of tendering or negotiation to obtain the optimum interest rates; bank charges et al.

- Once a Child Pensions Account is opened there will be no withdrawal of funds from the Child Pension Account unless in the event of the death of the child, where the Account is inherited by the next of kin.

- that the Child Pension Account will fall under the ownership of the child when he or she reaches 18 years of age.

- that the Child Pension Account will be transformed into a private pension account that is identified by the owner but the funds will not be released to the owner but would automatically be transferred to the pension instrument selected.

- that the Child Pension Account would not be accessible before the person reaches retirement age: that is, 65 years of age.

**Recommendation 39**

The 2010 Pensions Working Group recommends that the Government should consider to reform the Children's Allowance benefits scheme so that a parent on a voluntary basis may request the Department of Social Security to open a Child Pension Account from which there will no withdrawal, will become the child's property at the age of 18, the balance will automatically be transferred to a pension scheme of the owner's choice.

In order to incentivise an accelerated accumulation of the capital within a Child Pension Account, it is proposed that Government studies the impact of a fiscal incentive scheme that would provide a tax deduction for contributions up to a determined limit made by the parents or direct relatives of the child into the Pension Account.

**Recommendation 40**

The 2010 Pensions Working Group recommends that, in order to incentivise an accelerated accumulation of the capital within a Child Pension Account, the Government should consider studying the impact of a fiscal incentive scheme that would provide a tax deduction for contributions to a certain limit made by the parents or direct relatives of the child into the said Pensions Account.

Since the beginning of 2000 the OECD has established a Financial Education Project and many of its member nations have started to develop national strategies to improve the financial literacy levels of their citizens. Since then most international organisations as well as nations have introduced financial literacy programmes. This surge of interest in this area has been prompted by a number of factors.

First, there has been a proliferation of financial products available to consumers, largely spawned by technological advances and deregulation of the market for financial products and services in many OECD nations. This has been accompanied by an increase in the level of complexity that consumers face in trying to comprehend the different choices available to them.[117]

The second factor raising financial literacy to the fore is the ageing population, with the prospect in many countries of a much lower ratio of working age to retired citizens in the coming years, if people keep retiring at the same ages as now – similar to what Malta is experiencing.

Third, little is known about how households make their financial decisions. Researchers, however, speculate that one of the major reasons for low personal savings is that people have a difficult time deciding how much to save and how to achieve goals by a savings plan. Moreover, individuals do not entirely understand the relation between choices and outcomes. Finally, some individuals may not view saving and systematic budget planning as worthwhile, because of the uncertainties that the future holds and the inability to predict income, health, and labour-market conditions.[118]

Personal saving behaviour may not result from sophisticated planning, rather most individuals make their savings decisions based on their own, fairly rudimentary, judgment. Indeed, empirical evidence suggests that the majority of the population is not capable of making even the most basic economic calculations and that their financial knowledge is generally inadequate.[119] With the increase in mortgage debt in lieu of savings in Malta the danger exists that whilst households may be coping today they are particularly vulnerable to changes of circumstances or economic downturns as they will have limited additional disposable income that would provide them with the ability to manoeuvre during difficult times.

Fourth, with the advent of financial service providers both locally and internationally people are investing in complex products that they do not necessarily understand. The recent crisis showed that not only did many investors not understand credit ratings, but that some had not understood the basics of diversification and had lost all their savings by putting all their “eggs” in one “basket”.[120]

Financial literacy surveys in a number of countries have revealed low levels of financial knowledge in many areas, and a lack of awareness about the need to up-skill. In an Australian Survey carried out in 2003, for example, 67% of people interviewed stated that they understood compound interest, but when asked a question about this topic, only 28% answered correctly.[121]

Similar results have occurred in surveys in Japan, the U.S., the U.K. and Germany. In other surveys which focus on people’s attitudes to money and self-reported behaviour, results reveal that although many people are confident about their ability to budget and manage their money on a day to day basis, they are less confident about their ability to invest and plan their finances to ensure adequate provision for retirement. In addition to this many studies have shown that people find financial information difficult to find and understand, and that thinking about their long-term financial security can be ‘dispiriting or even distressing.’[122]

---

[117] Pg 11, National Strategy for Financial Literacy, New Zealand Retirement Commission, New Zealand, 2010
[118] Pg 5, Clancy, M., Grinstein-Weiss, M., and Schreiner, M., Financial Education and Savings Outcomes in Individual Development Accounts, Centre for Social Development, Washington University, St Louis, June 2001
[119] Ibid
[120] Pg 12, National Strategy for Financial Literacy, New Zealand Retirement Commission, New Zealand, 2010
[121] Ibid
[122] Ibid

A Financial Knowledge Survey carried out in New Zealand in 2005 found that[123]:

- 25 percent of people with home loans did not know that increasing the frequency of repayments from monthly to fortnightly reduced the amount of interest they would pay over the life of the loan.

- Only 30 percent identified that a range of shares would make more money than fixed interest investments and savings accounts over 18 years.

- When tested on their understanding of compound interest, only 53 percent correctly identified that they would earn more interest on a one year term deposit when the interest was accrued quarterly into the term deposit, rather than accruing at the end of the term.

- 20 percent thought they could reduce risk by investing only in property.

The Survey also identified that lack of knowledge in personal finance was across the population – irrespective of the level of wealth or education[124]:

- 15 percent of those with a net wealth of more than $300,000 had a low level of personal financial knowledge.

- 18 percent of those with tertiary or post graduate education had a low level of personal financial knowledge.

- 46 percent of those with no formal qualifications had a good or high level of personal financial knowledge.

- 8 percent who earned less than $20,000 were in the high knowledge group.

A survey carried out by Statistics Canada in April 2009 – the first of its kind – found that[125]:

- Nearly one-quarter of Canadians were found to be weak in three key areas of financial capability; namely, keeping track of their finances, planning ahead, and staying informed about financial matters; another 8 per cent were weak in all of the above-mentioned areas, as well as in making ends meet.

- More than one-third of Canadians said they were either struggling, or unable, to keep up with their finances.

- While 70 per cent of Canadians said they were preparing their finances for retirement, 30 per cent were not.

- About one-third of Canadians did not know the answer to, or answered incorrectly, a question in the Objective Quiz about what happens to their buying power when the inflation rate is higher than the interest they are earning on an investment.

- Only 35 per cent of Canadians knew that their investments in the stock market are not insured.

- Some 57 per cent of Canadians did not know the answer to, or answered incorrectly, a question in the Objective Quiz about the content of a credit report.

[123] Pg 13, Ibid
[124] Ibid
[125] Pg 12, Leveraging Excellence: Charting a Course of Action to Strengthen Financial Literacy in Canada, A Public Consultation Document, Task Force on Financial Literacy, February 2010

A similar Financial Survey carried out in the Netherlands carried out in 2008 finds that Dutch households do not plan much for retirement. The study confirms evidence provided by US surveys of the positive impact of financial literacy on planning for retirement using a representative sample for the Netherlands, a country with a completely different pension system and other financial education practices.[126]

Moreover, the research shows that the less financially sophisticated:

- will avoid the stock market (van Rooij, Lusari, and Alessie 2007, 2008; Kimball and Shumway 2006; Christelis, Jappelli, and Padula2006)
- are less likely to save for retirement (Lusardi and Mitchell 2006, 2007, 2008, 2009)
- are less likely to participate in their 401(k) plans (Agnew, Szykman, Utkusand Young 2009)
- are more likely to succumb to the default bias (Agnew and Szykman 2005).[127]

Furthermore, if individuals have insufficient knowledge concerning the saving process, they are unlikely to be able to make optimal retirement plans. A lack of financial education may result in workers starting to save too late in life and saving too little to reach their retirement goals. As a result, they are unlikely to achieve the desired balance between consumption while working and consumption in retirement.[128]

The Survey carried out by NSO on behalf of the PWG2010 is not a survey on financial literacy. As discussed earlier in this Report, however, trends relating to savings, investing in alternative instruments, and preparing for retirement are disconcerting.

The PWG2010 recommends that the NSO works with the Ministry for Pensions and the MFSA to carry out a specifically designed survey that will provide a baseline and acts as the starting point for assessing adult financial literacy in Malta.

| **Recommendation 41** |
|---|
| The 2010 Pensions Working Group recommends that the Government should task the National Statistics Office, the Ministry for Pensions and the Malta Financial Service Authority to carry out a specifically designed survey that will provide a baseline and acts as the starting point for assessing adult financial literacy in Malta. |

The PWG2010 is of the considered opinion that it would be surprising if the results are different from those of other countries. As shown, the results are consistent irrespective of the nation, culture, and location. Thus the PWG2010 believes that action to place financial literacy on the national agenda should not await the completion of this survey.

The recommendation that a Mandatory Second Pensions framework is introduced at the earliest together with the fact that evidence in hand seems to show that people are saving less demands immediate action.

The discussion on pensions and its reform from when the White Paper in 2004 was launched to the enactment of the legislation in December 2007 focused public attention on this issue. This was an excellent opportunity for the Government to entrench a sustained mechanism directed to develop and build financial literacy in Malta. Unfortunately this opportunity was lost.

[126] Pg 18, van Rooij, M., Lusardi, A., and Alessie, R, Financial Literacy and Planning in the Netherlands, DNB Working Paper, No 231, November 2009

[127] Agnew, J., and Szykman, L, Annuities, Financial Literacy and Information Overload, William & Mary Mason School of Business, April, 2010

[128] Pg 1, d'Ambrosio, B, M., Ignorance is Not Bliss: The Importance of Financial Education, TIAA-CREF Institute, Washington DC, November 2003

There is no doubt that this Report when submitted to the House of Representatives later this year will result once again in the positioning of pensions as one of the primary policy issues for national debate. This time the opportunity to complement the discussion with a permanent mechanism to inculcate a financial literacy culture in Malta should not be missed.

The PWG2010, therefore, recommends that the Ministry for Pensions together with the Ministry for Finance establishes, immediately in 2011, a permanent Task Force on Financial Literacy that is assigned the terms of reference to design and implement a financial literacy strategy directed to help people achieve the following:

- be able to make financial decisions related to home ownership, saving, preparing for retirement, et al.
- attain a better level of understanding with regards to financial services product that they own, may yet purchase and in preparation for the introduction of a Mandatory Second Pension.
- attain a level of knowledge that allow for the placement of smart attitudes and habits such as asking appropriate questions prior to making an investment choice.
- recognise mis-selling and other unethical behaviour as well as the ability to interpret the fine line details that accompany a financial services product.
- understand the basics of how the market operates and the principles of risk and reward that may result when making financial investment decisions.
- understand how inflation, interest rates and fees associated with saving, investment and debt work.

**Recommendation 42**

The 2010 Pensions Working Group recommends that that the Government should consider establishing in 2011 a permanent Task Force on Financial Literacy that is assigned the terms of reference to design and implement a financial literacy strategy directed to help people achieve the following:

- be able to make financial decisions related to home ownership, saving, preparing for retirement, et al.
- attain a better level of understanding with regards to financial services products that they own, may yet purchase and in preparation for the introduction of a Mandatory Second Pension.
- attain a level of knowledge that allows for the placement of smart attitudes and habits such as asking appropriate questions prior to making an investment choice.
- recognise mis-selling and other unethical behaviour as well as the ability to interpret the fine line details that accompany a financial services product.
- understand the basics of how the market operates and the principles of risk and reward that may result when making financial investment decisions.
- understand how inflation, interest rates and fees associated with saving, investment and debt work.

One of the principles and good practices for financial literacy approved by the OECD Council in 2005 is that “financial education should start at school [as] people should be educated about financial matters as early as possible in their lives".[129] The following three examples show the extent of seriousness that following advanced societies have taken on board the OECD's emphasis on the importance of the school system for financial education.[130]

Australia's "Understanding Money" website reflects a concerted attempt to support educators by developing curriculum materials, by establishing standards for quality materials and by adopting curriculum guidelines. Acting on the UK Government's policy to ensure that school leavers have the skills and confidence to manage their money well, the Financial Services Authority has taken steps to ensure that financial education is now part of England's national curriculum and has also provided training and materials for teachers. In addition, the Financial Services Authority has developed TV programs for teachers and pupils and made those programs available online.[131]

In the United States, the Financial Literacy and Education Commission's (2006) strategy deals with financial education in the school system, including proposing conferences or round tables to address the integration of financial education into the core school curriculum, and the Commission's meetings have dealt with the need for teacher training. In Canada, the Canadian Securities Administrators have developed the "Financial Fitness Challenge" on their website to teach basic financial skills to youth and young adults. That same site has a "Teacher Resource Centre" tab that leads to materials teachers can use in their classroom; the materials available over money, budgeting, saving, investing, and creating a budget.

Thus the, PWG2010 is of the considered opinion that the newly established Task Force, if the recommendation is adopted by Government, should enter into discussions with the Directorate for Education Services to establish within the curriculum of kindergarten level of education the fundamental basics of economics and to change the Curriculum of the Personal and Social Development subject at both the primary and secondary level of education to include modules on financial literacy.

Research shows that there are many basic economic concepts that can be taught and learned as early as kindergarten. An understanding of the differences between wants and needs, the concept of scarcity or even the law of supply and demand, if introduced early in a child's education, can help make the learning and understanding of more complicated concepts at higher cognitive levels much easier as the child progresses from grade to grade.[132]

The embedding of financial literacy concepts in the Personal and Social Development subject will help a student to become familiar with basic terminology and financial literacy principles. Throughout the primary level of education simple examples can be part of instruction within the subject. As students become more mature a more structured presentation of personal finance should be used.

Once students reach secondary school they would have been exposed to the fundamentals of financial literacy and will be better positioned to understand the more complex issues of personal finance.

**Recommendation 43**

The 2010 Pensions Working Group recommends that the newly established Task Force, if the Recommendation 32 is adopted by Government, should enter into discussions with the Directorate for Education Services to establish within the education curriculum the fundamental basics of financial management and literacy and to amend the Curriculum of Personal and Social Development subject at both the primary and secondary level of education to include modules on financial literacy.

[129] No 8, Recommendation on Principles and Good Practices for Financial Education and Awareness, Recommendation of the Council, OECD, July 2005
[130] Pg 26, Orton, L, Financial Literacy: Lessons from International Experience, Research Report, Canadian Policy Research Networks, September 2007
[131] Ibid
[132] Pg 8, Financial Literacy Implementation Committee Report, Ohio Department of Education in cooperation with the Ohio Treasurer of State and Ohio and the Ohio Council on Economic Education, April 2008

Schools should also be encouraged to broaden field trips and guest speakers to include representatives from the financial market – ranging from the Malta Financial Services Authority to financial banks.

The introduction of a Mandatory Second Pension will, as discussed earlier in the Report, mean that individuals have of necessity assumed greater responsibility for planning for their financial needs in retirement.

It is pertinent to note that research overseas finds that employee response to workplace financial education programs and the results of studies of the influence of such training on employee financial behaviour have generally been favourable. One study found that employees who attended training workshops subsequently increased their participation in US 401(k) retirement plans. Another study drew a similar conclusion, with more than half of those participating in counselling sessions and workshops changing at least one financial behaviour.[133]

In a study evaluating the effectiveness of financial education offered by a chemical production company, 75 percent of employees reported deriving a sense of benefit from workplace sponsored training; they believed that they had made better financial decisions after attending the workshop and were overall more confident in making investment decisions.[134]

Retirement accumulation, by nearly all measures, was found to be significantly higher for respondents whose employers offered financial education. In addition, rates of participation in US 401(k) retirement plans for both respondents and spouses were higher in the presence of employer-sponsored financial education. The study found a significant relationship between financial education and the rate of total saving.[135]

The proposed PWG2010 believes that the Task Force, if constituted, should in 2011 enter into discussions with the Employment and Training Corporation to introduce financial literacy training programmes for persons in employment. Moreover, the Task Force as from 2011 should establish a programme with the appropriate constituted bodies to assist employers to introduce seminars on financial literacy to their staff.

**Recommendation 44**

The 2010 Pensions Working Group recommends that the newly established Task Force, if the Recommendation is adopted by Government, should enter into discussions with:

- the Employment and Training Corporation to introduce financial literacy training programmes for persons in employment; and
- appropriate constituted bodies to assist employers to introduce seminars on financial literacy to their staff.

[133] Pg 451, Braunstein, S., and Welch, C., Financial Literacy: An Overview of Practice, Research and Policy, Federal Reserve Bulletin, November 2002
[134] Pg 452, Ibid
[135] Ibid

# Chapter 08: Strengthening Capacity for the Management of the Pensions System

The continuous balancing between financial sustainability of the pensions system and its macro-economic impact on the national economy with the need to ensure that a pension is of an adequate value is a policy process that requires sustained and continuous leadership, rigour, review, re-design and policy action.

Moreover, each strategic review, as in the case with this Report will result in the presentation of recommendations that would need to be developed further and implemented as appropriate. This means that capacity to maintain focus and momentum on evolving the pensions system is of strategic importance.

In tandem with financial sustainability and pension adequacy, the socio-economic factors that have a direct impact on the dynamics of the pensions framework is in continuous flux. As shown in this Report and the accompanying Supplementary papers, these include:

- Dramatical fall of indigenous birth rates.
- Increasing migrant birth rates.
- Increasing migrants.
- Low female larbour participation.
- Low elderly labour participation.
- Changing work patterns.
- Changing family patterns.
- Increasing demand for elderly care on family members.

This means the pensions policy is intrinsically tied, amongst others, to:

- Migration policy.
- Family and family friendlies policy.
- Larbour policy.
- Health and elderly care policy.
- Civil society policy.
- Employment policy.
- Savings policy.
- Finance management education.
- Education policy.

In this regard, the PWG2010 is strongly of the view that the Department of Social Security should be strengthened by the setting up of a Pensions Strategic Unit.

The setting up of a Strategic Pensions Unit that acts as a resourced and sustained vehicle that ensures continued organised review and calibration of the country's pensions infrastructure is a mandatory necessity.

It is proposed that the Strategic Pensions Unit will be responsible for the following:

- Work with the National Statistics Office on data elements required.

- Carry out directly or through the National Statistics Office surveys on aspects that relate to the pensions framework.

- Undertake economic and social research on matters pertaining to the pensions framework.

- Undertake policy development research and briefing including day-to-day enquires, major in-house / external demands such as the 5 year strategic review as mandated by the Social Security Act; the development of policies and the way they are delivered on matters including, but not limited to:

    - Drivers of savings behaviour.

    - Exploring the role of employers in improving savings through the work place.

    - Extending working lives.

    - Pensioner poverty and service delivery.

- Undertake modeling and forecasting of pension policy instruments directly or through the Economic Policy Division as the case may be.

- Monitor and analysis of policy progress and policy relevant developments in the broaden economy and society.

- Participate and monitor pensions policy developments at the European Union.

- Undertake and / or participate in strategic cross-cutting policy domain research on policy areas that impact pensions policy design as stated earlier.

- Undertake evaluation of pension policy and programmes and recommend improvements, calibration et al.

- Design, introduce and monitor education and information campaigns on savings for pensions.

- Work with the Malta Financial Services Authority and other stakeholders to design education and information campaigns to facilitate informed choice on Second and Third Pension respectively.

- Carry out consultations on policy options with constituted bodies, et al.

- Work with and liaise in policy design with other Government entities that impact the pension value chain.

| **Recommendation 45** |
| --- |
| The New Pensions Working Group recommends that the Government should consider strengthening the Department of Social Security by setting up of a Strategic Pensions Unit that would act as a resourced and sustained vehicle that ensures continued organised review and calibration of the Malta's pensions system. |

Additionally, as further shown by this Report, there is considerable important work that requires to be undertaken both in terms of further study as well as in supporting the implementation process once Government reaches its position on the recommendations presented for its consideration.

The Strategic Pensions Unit should not only be the critical link between each review and the next, but should also be the underlying coordinating entity on all matters relating to pensions policy design and research within which the accruing body of knowledge and experience is institutionalised.