

ACTUARIAL ASSOCIATION OF EUROPE

The Taskforce Adequacy approach to the Pension Adequacy Report
2018

The Pension Adequacy Report 2018

Prepared jointly by the **Social Protection Committee and the European Commission**

Analysing the adequacy of current and future pensions

Aiming to **support Member States in designing pension systems** that are adequate while remaining financially sustainable

Adequacy of pensions of men and women is defined along three dimensions

- Protecting pensioners against poverty
- Replacing the former earnings to a reasonable degree
- Considering the expected duration of their retirement

Risk of poverty: Poverty and severe material deprivation measured by „at-risk-of-poverty” (AROP) using total equalized household net disposable income at age 65+ (and AROPE)

Income replacement

- Aggregate replacement ratio (ARR)
- Theoretical Replacement Rate (TRR)

The length of retirement affect both adequacy and sustainability

- Find an adequate and sustainable balance between the duration of working life and the duration of retirement
- Taking into account labour market aspects as well

When talking about adequacy... – AAE considerations

„Attention should be paid to adequacy of the benefits for poverty prevention and income replacement, taking into account pension durations”

- The main concern is that **under more financially sustainable pension costs pension adequacy will decline**
 - What constitutes **sustainability in itself is not defined**, but
As a **Pareto optimum**, it is not sustainable to have an ever increasing share of national income required to pay pensions
 - What constitutes **an adequate pension depends** on what needs it is expected to cover
In old age in addition to **the consumption of goods and services**, it is likely include essential care (AROE)
- **Pension systems designed for people in standard employment** involves consideration of both adequacy and financial sustainability
 - **Career patterns** and expected pension have changed: There is a high degree of differentiation between employment statuses
- **What is covered by which pension scheme?** How and how well they are integrated?
 - Different tax-financed publicly-provided schemes, services and goods (e.g. subsidized access to LTC), provided in the MSs

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Main findings

Risk of poverty in old age

EU: 17.3/95 million (18.2%) of age 65+ people is at risk of poverty or social exclusion

- That is fewer than before the crisis but nearly unchanged since 2013 in the EU on average

AROPE: - decreased in 16 MSs, with a fall of more than 10 percentage points in Bulgaria –

- increased in 12 MSs, with the highest increase in the Baltic States and Malta – due to limited redistribution and the lower effectiveness of social safety nets

Income replacement

- Pension after retirement / Late-career income is 58%, while
- Average pensions / Average work income is 93%
- Also, in general, older people is less exposed to risk of poverty
 - Pension is the main source of old age income

The duration of working and retired life is changing

- The time spent in retirement is 51% of the time spent in active age
 - Employment in age 55–64 grew by 5.1 %p because of later retirement **and** pension reforms
- Time spent in retirement it will increase to 53% by 2060 as life expectancy improves faster than the labour market options for elderly people
 - Longer working lives will be necessary to achieve adequate pensions: if other conditions remaining the same, retirees with similar careers in 2056 will have lower replacement rates than in 2016

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Main findings on social security and supplementary pension reforms

On adequacy: Improving adequacy after sustainability driven reforms

- **Basic and minimum pension** in Greece, Austria, Belgium, Bulgaria, Cyprus, Ireland, Malta, Poland, Romania, Slovakia and Slovenia
- **Targeted additional benefits** aimed to improve low benefits by ad-hoc increases in the Czech Republic, Estonia, Italy and Sweden
- **Changing old age benefit taxation** (raising the non-taxable minima) had a similar effect in Latvia, Malta and Romania.

Policy advice

- The pension systems will have to cover different types and forms of employments and other economic activities to improve the future adequacy of old-age incomes
- That is, non-standard or self-employment, diverse work patterns, with career breaks of social reasons, and adapting accrual conditions to build up adequate pension rights
- Older women will remain the main users of minimum income schemes

„Complementing statutory pensions with broad and well-designed supplementary schemes”

- In some MSs occupational pensions are maturing, while in many others the coverage remains very low
- The potential measures highly dependent on the national context, but
- [...] May include mandating or auto-enrolment, as well as cost-effective access for different groups, collective bargaining, tax and financial incentives, and promoting awareness of different saving options

Pension adequacy and reforms – AAE views

The plethora of continuing reforms suggests that most MS have not reached a point of being comfortable with financial sustainability and corresponding adequacy in the pensions system

Finding the balance between Sustainability vs Adequacy reform measures

- Austerity measures were not only objected to by the population but also challenged by some economists
- During the period of recovery from the financial and economic crisis, observing a different direction of reform provisions also supporting consumption-driven growth in the pensioners' segment of the society

After a period of reforms driven by sustainability several MSs are moving towards adequacy improvements

- Introduction of basic pensions, improving minimum and/or basic pensions and/or targeted additional benefits
- Indexation was used to improve the real values of pensions
- Temporary contingency measures were withdrawn: in the areas of indexation, reversals of pensionable age rules, measures of (re)-introduction of schemes for special occupational categories

Automatic Adjustment Mechanisms (Automatic balancing mechanism + Sustainability factor (linking benefits/rights to changes in life expectancy/demography/economic indicators) + Retirement age linked to life expectancy)

- The above measures should be applied consistently

New approaches in pension reforms – AAE views

Working life duration must be seen in relation to **retirement duration** for intergenerational fairness

- However, an adequate **balance of the durations** may affect the income replacement and the poverty prevention

Bonus/Malus:

- Early retirement penalties appears generally less than actuarially neutrals
- Actuarially fair incentives would ensure rewarding working longer and delaying retirement

Facilitating deferred retirement: flexible retirement

- Should be used in a flexible retirement system, together with reduced working hours/part time work is supplemented by reduced/part-pension benefit, the first decreasing and the latter increasing until full retirement

The trend of taking into account increasing life expectancy also continued

- not only raising the required service period and retirement age
- but incentives to work longer – such as bonus-malus schemes and flexible retirement programmes, which needed employer/labour market support; combining work and pensions may target multiple, and sometimes more general, social and economic objectives

Linking the pensionable age to increase in life expectancy

- extending the active period, or maintaining constant the ratio of 1/3 to 2/3 between the retired and the active period
- Some countries are using/planning to use expectation of life to propose adjustments to NRA in one way or another

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Main conclusions – Digging deeper: Vulnerable groups

The EU average never gives the full picture

- Increase in income inequality in old age is up in 16 / down in 9 MSs, and in poverty depth up in 19 MSs

There is a great difference between women and men

- The risk of poverty or social exclusion in old age increases with age: More than half of people of AROPE are aged 75+
- That is deteriorating from the situation after retirement (indexation) and changes in old age service needs (LTC)
- The difference in career length and pay is the effect of the multiple career gaps affecting women (childcare breaks, part-time, work, care for dependent adults) has impact on women's pensions, despite of pension credits
- Leading to the gender gap in pensions is 37.2%
- 20%+ women aged 65+ are exposed to AROPE, compared to 15% men
- Women are more likely to live longer, live alone and have lower pensions, and
- Consequently the population share of older, single women with low pensions will increase

People in non-standard and self-employment

- Often face less favourable conditions for accessing and accruing pension rights, end up having lower pensions
- Only in theory better covered by supplementary pensions, whereas matured funded systems are occupational

People with career breaks for social reasons

- Usually compensated with only limited credits in the main system, and
- Limited opportunity to contribute to funded schemes

Adequacy effects of reforms increasing career-length – AAE views

Working longer entails longer exposure to labour market/business risks for employees/self employed

- Everyone who, couldn't manage for a long and adequately paid career job throughout his/her working life, for any reason, then as pensioners he/she will be at a higher risk of entering poverty

Women

Poverty risks are related to income decline and to changes in the household size

- The long periods of exclusion of women from the labour market bc. of unpaid caring roles leads to lower pensions
- The AROP rate is closely linked to the household type: Single older people, majority women, have generally much higher poverty rates than older couples

Vulnerable groups

- The share of non-standard workers (temporary and part-time workers) in total employment has increased substantially in most MSs
- The poverty risk rate for non-standard workers and the self-employed is considerably higher than for standard workers
- There is a high degree of differentiation between employment statuses (employment and self-employment) in several MSs' social security systems

Adequate social benefits (pension, unemployment benefits) should be available to all employed and self-employed. Attention should be paid on the non-average different profiles of the individuals.

Awareness and uncertainty

- As life expectancy improves, pension income for a career of a similar number of years will become relatively lower
- Still, it is very difficult to rise awareness to this risk, however important it is

Responsible of the profession could be

- providing people with fitting default pension products, or
- helping them with a good choice architecture in order to help people not to end up in poverty

From actuarial perspective we would regard important to achieving balance between sustainability of pension systems and adequacy of old age benefits

- pension costs should be a relatively affordable and not growing significantly over the long term
- resilience to ageing of the population, through some form automatic adjustment mechanisms at retirement age to offset increasing length of life
- significant element of protection is necessary for those on low incomes through minimum guarantees in the public pension system
- robust funded second and third pillar pension arrangements may supplement income replacement

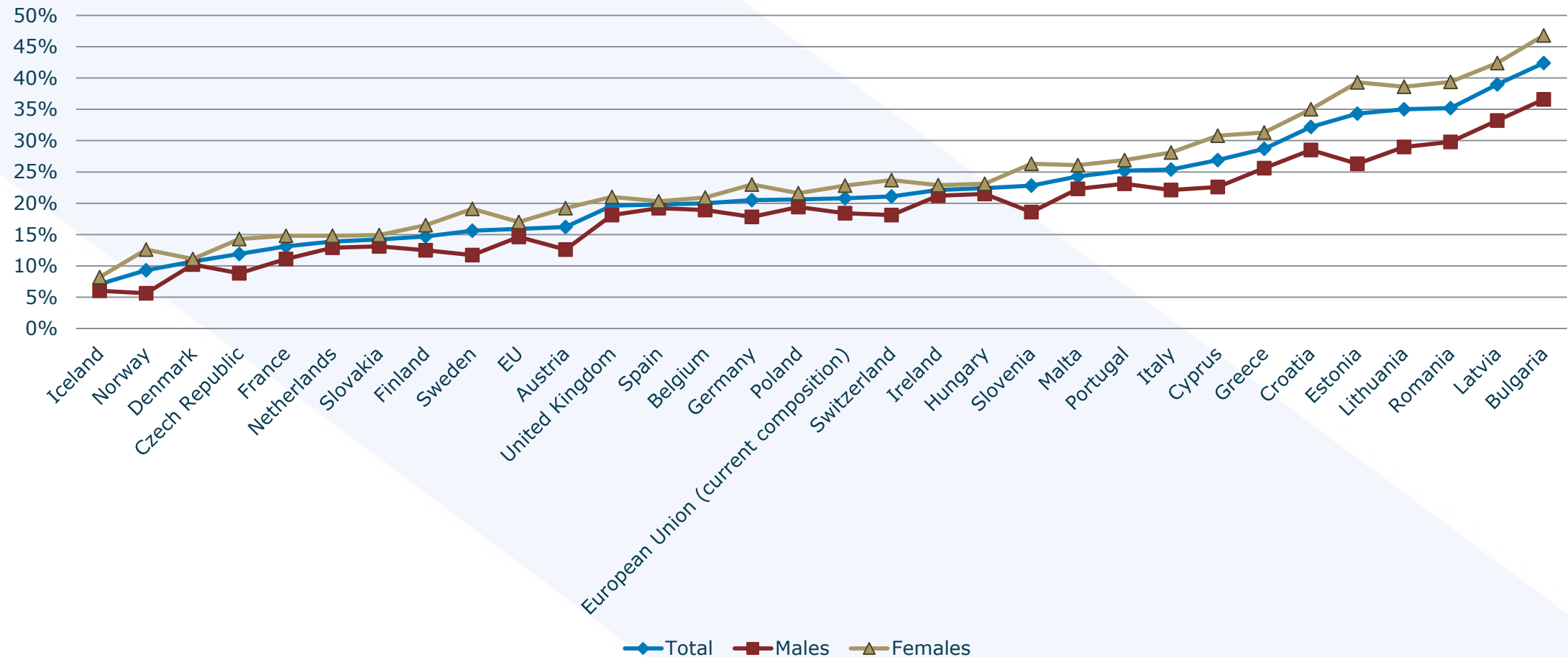
The Taskforce on Adequacy continues to focus on

- Adequacy measures and their interpretations, intragenerational fairness
- Pensions of Vulnerable groups, especially minimum and social pensions
- Supplementary/Complementary pensions and their integration in the pension systems, information provision on pension rights and benefits

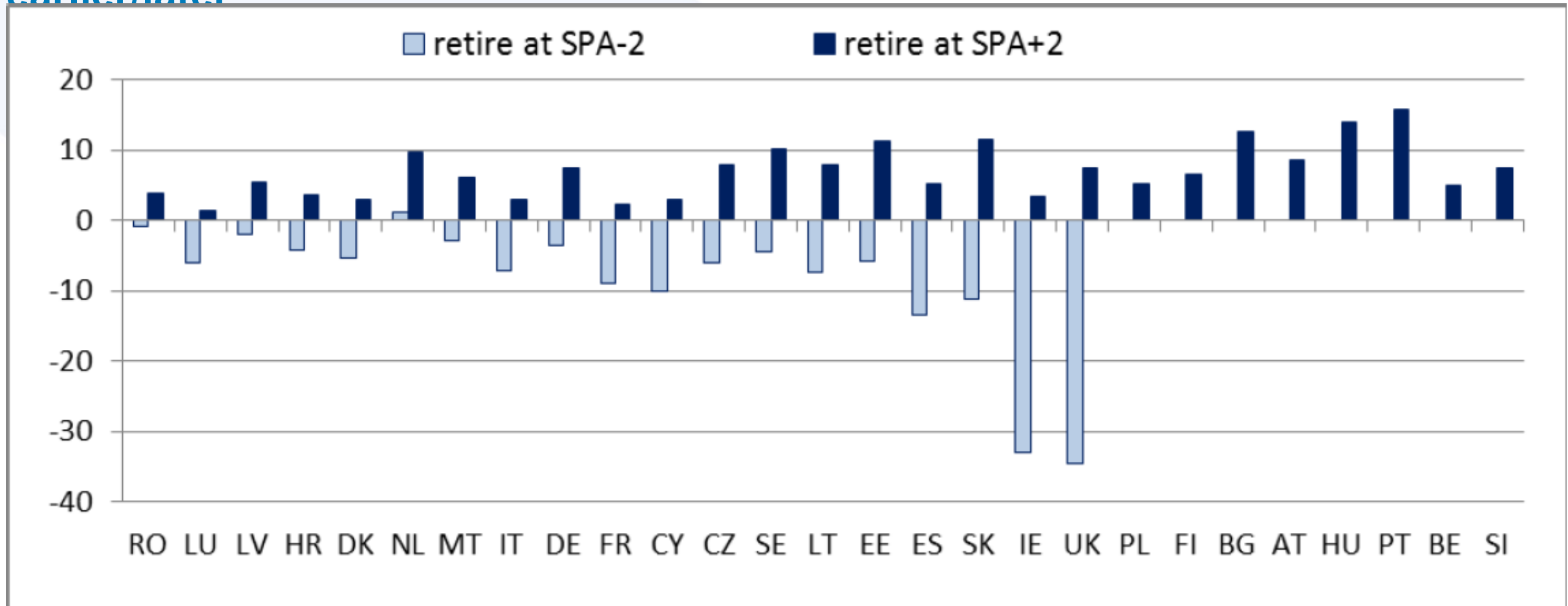


Appendix - Illustrations

Risk of poverty: AROP 55+, 2016



Income replacement and duration of working/retired periods, according to present regulations: Net TRR, differences between the cases retiring 2 years earlier/later



Summary of recent pension reforms

Country	Contributions	Special categories	Eligibility conditions	Early retirement	Work and pension	Qualifying period	Pensionable age	Benefits in payment	Indexation rules	Minimum guarantee	No. of Measures*
Finland	X	X	X	X	X	X	X	X	X	X	10
Greece	X		X	X	X	X	X	X	X	X	9
France	X	X	X		X	X		X	X	X	8
Belgium			X	X	X	X	X	X			6
Bulgaria	X	X		X	X	X	X	X			7
Italy	X	X		X		X		X	X		6
Portugal			X	X			X	X	X		5
Czech Republic						X	X		X		3
Germany	X			X	X					X	4
Romania	X	X		X	X						4
Austria				X	X						2
Croatia	X	X							X		3
Latvia		X							X		2
Lithuania						X		X	X		3
Slovakia			X						X	X	3
Spain			X					X			2
United Kingdom						X	X	X			3
Ireland								X			1
Malta				X		X					2
Poland						X	X				2
Hungary	X										1
Netherlands							X				1
Slovenia					X						1

Multidimensional measures of pension systems – Rating

Ranking of pension systems : An overall ranking is a weighted average of the sub-indicators

The Melbourne Mercer Global Pension Index 2017

Includes 13 European countries, including Norway and Switzerland

Rating categories

- Adequacy (the benefits that are currently being provided together with some important system design features),
- sustainability (focusing on the future and measures various indicators which will influence the likelihood that the system will be able to continue to provide the benefits), and
- integrity (considering several items that influence the overall governance and operations of the system which affects the level of confidence that the citizens of each country have in their system)

The Allianz Pension Sustainability Index

Covers 54 countries worldwide, including all 28 EU Member States, Norway and Switzerland

Rating categories: demographics, public finances and pension system

It is noteworthy that the same countries come high in this list as in the Mercer analysis, although, apart from Denmark heading both lists, the next few countries are not in the same order in both lists and there are some surprises among the countries ranked quite highly by Allianz

Mercer	Allianz
1. Denmark	1. Denmark
2. Netherlands	2. Sweden
3. Norway	3. Netherlands
4. Finland	4. Norway
5. Sweden	5. Latvia
6. Switzerland	6. Estonia
7. Ireland	7. UK
8. Germany	8. Switzerland
9. UK	9. Lithuania
10. France	10. Finland

Taskforce Adequacy: steps forward

Topics for common interest, projects continued, new projects may include:

- Adequacy measures topics – by definition, including others than used in the Reports (Pension Wealth)
- Focus on vulnerable groups
- Minimum Pension Guarantees in the social security scheme or as separate social insurance system
- Comparability issues of adequacy and sustainability measures:
 - adequacy: micro vs macro concept, measures
 - forecasting results from different sourced; mapping differences in timing, demographic sources, economic assumptions, methodology, etc.
- Tracking services/Pension dashboards
- Collection of background and reference papers, academic articles follow

Tibor Párniczky, SSSC TF Adequacy chairperson
email: parniczky.tibor@upcmail.hu