

Financing disability pensions – the Finnish experience

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ELÄKETURVAKESKUS

The Finnish statutory pension system

- Defined benefit, legislation in several pension acts
 - The largest acts are the Employees Pension Act (TyEL), the Public Sector Pension Act (JuEL) and the Self-employed Persons' Pension Act (YEL)
- Implemented by several pension providers
- Quite unique financing technique
 - A single pension provider ("the last insurer") pays out the pension of a single pensioner
 - Several pension providers might have received contributions during the working career and might be liable for some pension component
 - The division of costs is performed in The Finnish Centre for Pensions



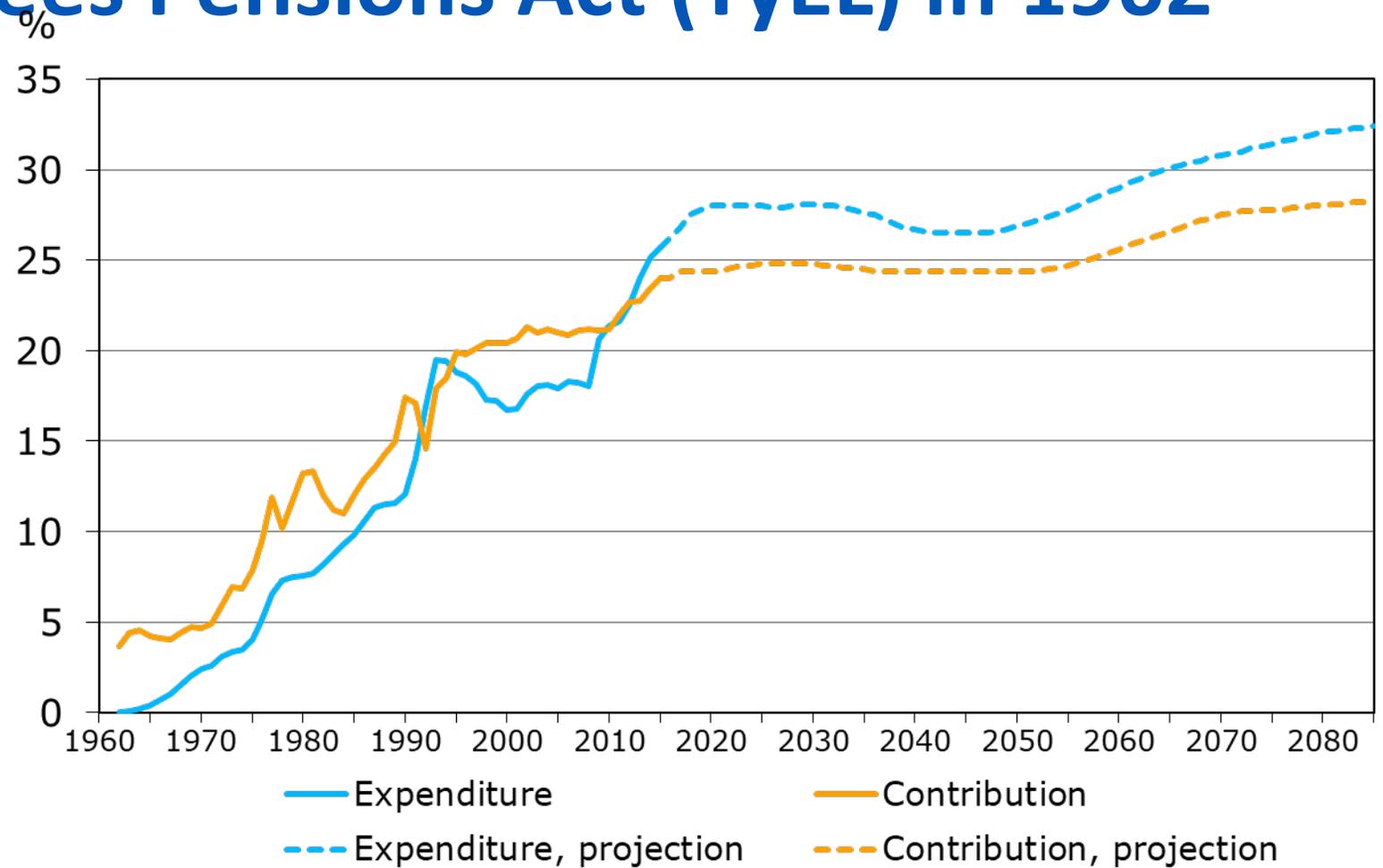
Private sector employees and TyEL

- TyEL pension providers are private sector operators
 - pension insurance companies (4 working in 2022, 98 % share of insured wage sum)
 - company pension funds (8 in 2022) or industry-wide pension funds (4 in 2022)
- TyEL is implemented with a partial funding technique
- Each pension consists of a funded and an unfunded component
 - A single pension provider is liable for the funded component
 - Collective responsibility for the unfunded (pay-as-you-go) component and indexation
- For old-age pensions:
 - 0,4 % accrual for the funded component (total 1,5 % accrual for TyEL)
 - additional funding requirements from investment returns





Pension expenditure and contribution rates in proportion to the wage sum under the Employees Pensions Act (TyEL) in 1962–2085



Experience rating - history

- Experience rating dates back to the early days of TyEL
 - Pension companies mimicked employer incentives from company pension funds
 - The employer should have an incentive to avoid disability of their workers
- In 2006, implementing IFRS standards forced major changes to experience rating
 - IAS 19 standard for employer benefits was interpreted so that the benefit depends on the length of service, and thus obligation arises during employment (currently article 157). To avoid additional liabilities for employers, the defined benefit scheme was forced to transfer into a defined contribution scheme.
 - Current contribution category model with 11 categories was introduced
 - The link between benefit and contribution need to be cut; no more refund from rehabilitation



Experience rating – Current model (1/2)

- At occurrence of disability, the pension company reserves liability until expected old age pension
 - A young person's disability is more expensive
 - Pension company's liabilities related to one employer's insurance contract affect the employer's risk level and hence contribution category
 - The link between worker's disability and employer's contribution might seem complicated in the employer's perspective



Experience rating – Current model (2/2)

Employer size effect experience-rated contribution

- Full experience-rated contribution for employers with an annual wage sum of over €34 million
- Partial experience-rated contribution if annual wage sum is over €2 million
 - Experience-rated component of the contribution increases linearly



Only permanent disability effect experience-rated contribution

- Disability benefits are either temporary or permanent
- To encourage rehabilitation, affect from permanent benefit only
 - In case of eventual permanent disability the time interval between at first falling ill and the affect on employer's contribution can be several years

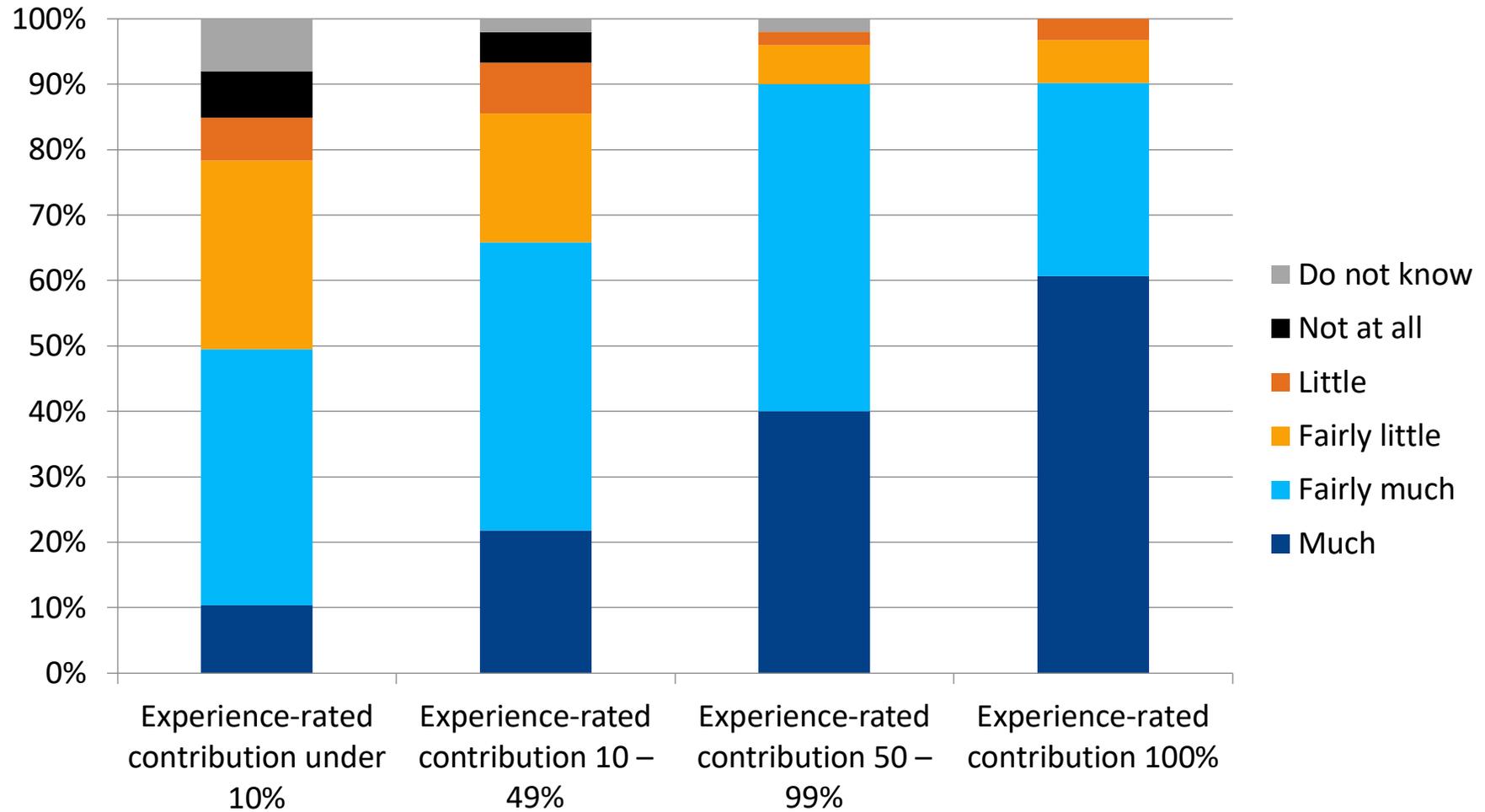


Incentive effects of the Finnish experience-rating model according to questionnaire

- Employer questionnaire of the Finnish Centre for Pensions (Liukko & Polvinen & Kesälä & Varis 2017)
 - The larger the employer, the more often the experience-rating model spurs to taking care of workers' ability to work
 - Also unintended effects on recruiting risk groups
 - Experience-rating model perceived to be complicated and partly unfair



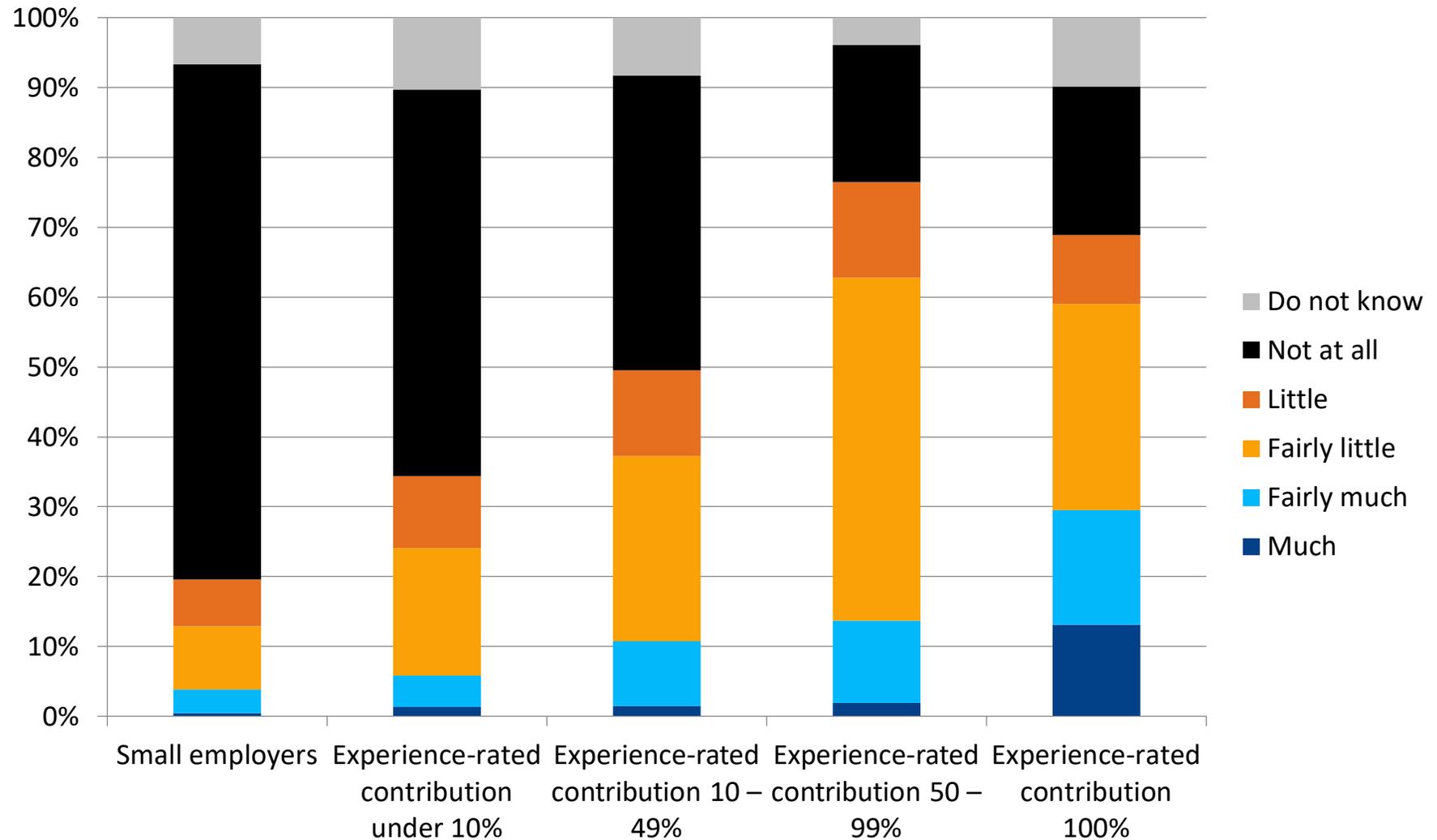
Does the experience-rating model spur your company to take care of your workers' ability to work?



Source: Finnish Centre for Pensions



Has the financing model of disability pensions (experience-rating model) affected how your company recruits?



Source: Finnish Centre for Pensions



Incentive effects of the experience-rating model according to register studies



- No clear evidence that the incentives of the current Finnish experience-rating model would reduce the disability risk considerably
- Exception: men under 50 years
 - See studies by Kyrrä et al in 2012 – 2018
 - The studies have hardly been able to utilise legislative changes
- Employment effects of the experience-rating model
 - More research required
- The model has been under much debate!



References:

- [Financing and Investments - Finnish Centre for Pensions \(etk.fi\)](#)
- [Long-term Projections - Finnish Centre for Pensions \(etk.fi\)](#)
- Employer incentives for reducing absence from work due to sickness and disability in Finland and the Netherlands, Meeri Kesälä and Jyri Liukko, draft 2021

